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James Harvey Jordan, Et Al. v. Eddie R. Jensen and Ly-Thi Jensen : Brief of Utah State Tax Commissions as Amicus Curiae on Behalf of Appellees

Utah Supreme Court

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[redacted]

IN THE UTAH SUPREME COURT

JAMES HARVEY JORDAN, ET AL., Appellees, v. EDDIE R. JENSEN AND LY-THI JENSEN, Appellants.	Appeal No. 20150257-SC
EDDIE R. JENSEN AND LY-THI JENSEN, Appellants. v. JAMES HARVEY JORDAN, MARTHA JORDAN BORIGHT; MARY EDNA JORDAN; AXIA ENERGY, LLC; AND STONEGATE RESOURCES, LLC, Appellees.	

BRIEF OF UTAH STATE TAX COMMISSION AS *AMICUS CURIAE* ON BEHALF OF APPELLEES

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The Utah State Tax Commission (hereinafter "Tax Commission" or "Commission") hereby files this Amicus Brief in the above captioned matter to explain when and how the Tax Commission exercises its jurisdiction to value mineral reserves so that this Court's decision will not inadvertently impact the Commission's current assessment and valuation practice.

BACKGROUND

This appeal involves a dispute over who is entitled to receive royalties on the production of oil and gas from a well drilled in 2012 in Uintah County. The Appellants contend that they own the rights to the mineral estate because they acquired the subject property in a tax sale. One of the underlying factual considerations is under what circumstances does the Tax Commission exercise its jurisdiction to value and assess mineral reserves.

The Tax Commission believes it is important for this Court to understand why the Commission has not and does not value undeveloped mineral reserves separately from the surface estate for property tax purposes. The Tax Commission is not aware of how it could presently value undeveloped reserves in a manner that meets the uniformity requirement of Utah Const. Art. XIII § 2(1). This brief sets forth the consistent historical and current treatment of, as well as the legal and policy bases for, the Tax Commission's current Rules in this area that do not separately value undeveloped mineral reserves in Utah.[1] The Tax Commission contends that in accordance with the Constitutional

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[1] The Commission has recently become aware of county concerns regarding portions of the District Court's ruling on the tax lien date and whether or not county assessments of

requirements of uniformity and equality, it has not separately valued or assessed property taxes on undeveloped mineral reserves in Utah because taxes cannot be imposed on such reserves in a uniform manner.[2] Under current government staffing and funding, and industry standards of classifying mineral and petroleum reserves, accurate consistent identification and valuation of undeveloped reserves is not possible. As such, uniformity and equality cannot be met and taxes may not be imposed.

The issue of when the Tax Commission separately values undeveloped mineral reserves is important to the Tax Commission. The Tax Commission requests the Court to maintain the Tax Commission's current practice by not inserting precedential language into its opinion which might have the inadvertent effect of requiring the Tax Commission to find and value all such undeveloped reserves for the purpose of applying a property tax. The issue of when reserves are quantified with reasonable certainty, have a reasonably determinable value, and can be economically extracted, is a complex factually driven inquiry. This issue should be first left to the Legislature and the Tax Commission, (the latter as the body charged with the power to "assess mines" under Article XIII,

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property include mineral rights. Because those issues directly impact the counties and the parties to this appeal, they should address them. This amicus brief focuses on the issue relating to the Tax Commission's assessment authority over certain classes of property under Utah Code Ann. § 59-1-201 et seq. ("central assessment" or "centrally assessed properties") rather than properties assessed by the counties under 59-1-301 et seq. or tax lien and tax sale issues that the counties administer.

[2] The Tax Commission assesses patented mining claims of non-operating mines. It does so by using the land values developed by the respective county. Reserves or mineral rights may be a part of the property rights associated with the mining claims, but the Tax Commission does not separately value them.

Section 6 of the Utah Constitution), and appropriate tax cases brought before the Utah district and appellate courts.

ARGUMENT

I. THE TAX COMMISSION DOES NOT SEPARATELY VALUE UNDEVELOPED MINERAL RESERVES.

As outlined below, the Tax Commission has not historically separately valued "undeveloped" petroleum (oil and gas) reserves or mineral reserves that are not "proven and probable," or, in the case of a productive mine, the reserves are not otherwise valuable to a reasonably quantifiable level. Throughout this brief, unless otherwise noted, the term "undeveloped reserves" shall include both (1) undeveloped reserves in an oil or gas field, and (2) non-oil and gas minerals that are not classified for SEC purposes as proven or probable reserves.[3]

The Tax Commission urges the Court to avoid issuing a ruling which would change this practice. In order to better understand the Tax Commission's practices, a brief introduction to terms related to mineral reserves is first warranted followed by a brief foundation regarding the Tax Commission's authority to assess mineral rights.

A. Defining Types of Reserves.

Oil, gas and other mineral reserves are classified into various categories by the United States Securities and Exchange Commission and by industry standards so that companies uniformly report the reserves on their books. *See e.g.,* 17 C.F.R. 210.4

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[3]The use of the reserve classification terms, such as "undeveloped reserves" are not determinative of taxation in isolation. When considering the assessment of mines and wells, the Tax Commission looks at the totality of information surrounding the resource. For example, a property owner may for some purposes classify a reserve as "undeveloped," but other evidence may indicate the reserve is "developed" under SEC and industry classifications.

(2015); Guidelines for Application of the Petroleum Resources Management System[4] for oil and gas reserves;[5] 17 C.F.R. 229.801(g) (2015), Industry Guide 7 and the SME Guide for Reporting Exploration Results, Mineral Resources and Mineral Reserves for other mineral reserves. As outlined below, these SEC and industry definitions have been used in Utah to define what is and is not subject to property tax.

For oil and gas, "developed reserves" are, in general, those "that can be expected to be recovered . . . [t]hrough existing wells." 17 C.F.R. 210.4-10(a)(6) (2015). In contrast, "undeveloped reserves" are, in general, those "that are expected to be recovered from new wells on *undrilled acreage*." 17 C.F.R. 210.4-10(a)(31) (emphasis added). Similarly, Utah Admin. Code R884-24P-10 (2015) only values "productive underground oil and gas rights" rather than those that are not drilled as discussed in more detail below.

For non-oil and gas minerals (such as copper or coal), a "Reserve" is "[t]hat part of a mineral deposit which could be economically and legally extracted or produced at the time of the reserve determination." 17 C.F.R. 229.801(g) (2015) and Industry Guide 7(a)(1). However, only proven or probable reserves are sufficiently known, identified, and capable of economic extraction to allow SEC reporting. *Id.* and Industry Guide 7(b)(5). "Proven (measured) reserves" are "[r]eserves for which (a) quantity is computed from dimensions revealed in outcrops, trenches, workings or drill holes; grade and/or

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[4]See,http://www.smenet.org/docs/publications/2014_SME_Guide_Reporting_%20June_10_2014.pdf (last visited November 12, 2015) Also see the Joint Ore Reserves Committee (JORC) guidelines.

[5] See, https://secure.spee.org/reserves-definitions-committee-rdc (last visited November 12, 2015).

quality are computed from the results of detailed sampling and (b) the sites for inspection, sampling and measurement are spaced so closely and the geologic character is so well defined that size, shape, depth and mineral content of reserves are well established." *Id.* and Industry Guide 7(a)(2). In contrast, "Probable (Indicated) reserves" are "[r]eserves for which quantity and grade and/or quality are computed from information similar to that used for proven (measured) reserves, but the sites for inspection, sampling, and measurement are farther apart or are otherwise less adequately spaced. The degree of assurance, although lower than that for proven (measured) reserves, is high enough to assume continuity between points of observation." *Id.* and Industry Guide 7(a)(3). Similarly, Utah's administrative rule only requires valuation for proven and probable reserves (discussed in more detail below). *See* Utah Admin. Code R884-24P-7(B)(2)(2015).

B. The Tax Commission Values Mineral Reserves of Productive Mining Property.

As stated above, the Tax Commission separately values the mineral reserves of productive mining property. Since its creation in 1929 through an amendment to the Utah Constitution, the Tax Commission has had the constitutional and statutory authority to assess all mines and mining claims. Utah Const. Art. XIII § 6 ("The State Tax Commission shall: . . . (b) assess mines."); Utah Code Ann. § 59-2-201(1)(a)(v) ("all mines and mining claims" are to be centrally assessed by the Commission). A "mine" is statutorily defined as "a natural deposit of either metalliferous or non-metalliferous *valuable* mineral," and "non-metalliferous minerals' includes . . . oil [and] gas." Utah

Code Ann. § 59-2-102(24), (27) (emphasis added). Accordingly, it is the Tax Commission that is responsible to find and assess any taxable reserves of productive mining property so that a tax may be applied to the market value; *i.e.*, those with value.

A related issue, on which the Commission will not opine and which it believes can be adequately addressed by the other parties to this litigation and the Utah counties (should they wish to be heard), is whether mineral rights are part of the bundle of property rights included in the counties' assessment and valuation of properties.[6] In other words, are mineral rights with no value or a de minimus value included or impounded in assessments where they are not separately valued?

C. The Tax Commission's Administrative Record and Decisions Show That It Historically Has Not and Currently Does Not Separately Value Undeveloped Reserves for Property Tax Purposes.

The Tax Commission's administrative record on the issue of not separately valuing undeveloped reserves is substantial. The record shows that the Tax Commission does not presently separately value, and has not historically separately valued, property tax on undeveloped reserves. (Oil and gas reserves and other mineral reserves are treated under different rules and are separately discussed herein.)

Rule R884-24P-10 (2015) ("Rule 10") is the rule used by the Commission to separately value and assess oil and gas reserves. In 1991, the Commission held public hearings in connection with a proposed amendment to its Rule 10 wherein the

[6] This issue also applies to the Tax Commission's valuation of non-productive patented mining claims. However, the counties, through their treasurers and auditors, levy and collect the property tax on Tax Commission assessments as well as their own assessments and so are the parties potentially impacted by a decision on this issue.

Commission proposed using a "discounted cash flow" (DCF) method to value oil and gas properties. *See* Tax Commission Summary Judgment Order in Appeal No. 03-0937 (Nov. 16, 2004), at p. 26-34 (attached hereto as Exhibit A). On November 13, 1991, Uintah, Summit, Duchesne, Grand, and San Juan Counties, their constituent school districts, and the Utah State Office of Education submitted comments (attached hereto as Exhibit B) requesting that the rule amendment include "valuation of undrilled leases and undeveloped reserves." At a public hearing on December 19, 1991, arguments were made that "the DCF method did not capture the effect of undeveloped leases." *See* Tax Commission Appeal No. 03-0937, at 31.

In early February, 1992, "[t]he Commission received letters from the [same] taxing entities that had opposed the Rule 10 amendments, whereby they informed the Commission that they were withdrawing their objections to the proposed amendments to Rule 10" as part of a settlement of earlier contested tax appeals. *Id.*, at 32. Further, they "agreed that the DCF valuation model, as proposed by the Division, should be used to value oil and gas companies for the [current] tax year." *Id.*

The application of this rule to undeveloped reserves was then tested in 2003. Uintah County appealed the assessed value of a taxpayer, and argued that undeveloped reserves of that taxpayer should be valued and taxed. In its decision in that case, the Tax Commission, while expressly reserving the question of whether undeveloped reserves are subject to property tax, stated that "[u]nder Rule 10, historically and including the 2003 tax year, the valuation model used to determine the fair market value of property owned by a centrally assessed oil and gas company, for assessment and taxation purposes, has measured the impact of value attributable to its developed oil and gas reserves, but has not measured the impact of value attributable to its undeveloped oil and gas reserves. . . . The Rule 10 administrative record clearly indicates that the Commission was aware, when it adopted the amendment in 1992, that this DCF model was not intended to measure the impact of undeveloped oil and gas reserves." *See* Tax Commission Decision 03-0937, at p. 34. (Attached hereto as Exhibit A.)

The Commission added that "[a]s the agency given the powers and duties to administer and supervise the tax laws of this state, the Commission is aware and also takes official notice of the fact that value that might be attributable to undeveloped reserves has not been specifically accounted for in the appraisal methods used in Utah under Rule 10." *Id.* at 33. Thus the Commission recognizes that sometimes undeveloped reserves do have value, such as when they are directly purchased. However, the Commission ruled in its decision in case 03-0937 that undeveloped reserves could not be valued and taxed in 2003 because to do so for only one taxpayer without finding and valuing undeveloped reserves for all taxpayers would violate the uniformity clause of the Utah Constitution. *Id.* at 44-45. Under this 2004 decision, the Tax Commission has continued to assess oil and gas properties under Rule 10, and has not valued undeveloped reserves.

Importantly, the Tax Commission is unaware of any evidence or information in its administrative record suggesting that undeveloped reserves in oil or gas fields have ever been valued or taxed since statehood in 1896, even before the adoption of Rule 10 in 1992.

Minerals other than oil and gas are valued and assessed by the Tax Commission pursuant to Rule R884-24P-7 (2015) ("Rule 7"). The Tax Commission promulgated Rule 7 in its current form in 1998, specifying that minerals need to be reported to the Tax Commission only when they are part of a mine plan for "proven and probable reserves." *Id.* at (B)(2).

II. THE TAX COMMISSION DOES NOT SEPARATELY VALUE UNDEVELOPED MINERAL RESERVES FOR PROPERTY TAX PURPOSES BECAUSE IT CANNOT DO SO UNIFORMLY AS REQUIRED BY THE UTAH CONSTITUTION.

The Utah Constitution requires that assessment of property occur "at a *uniform and equal* rate in proportion to its fair market value." Utah Const. art. XIII, § 2(1)(a) (emphasis added). "[T]he law has long been that where 'it is impossible to achieve both the standards of the true value, and the uniformity and equality required by law, the latter requirement is to be preferred as the just and ultimate purpose of the law.'" *Rio Algom v. Rio Algom v. San Juan County*, 681 P.2d 184, 194 (Utah 1984) (quoting *Sioux City Bridge Co. v. Dakota County*, 260 U.S. 441 (1923)).

Additionally, Utah Code section 59-2-201(1)(a)(v) requires the Tax Commission to assess all "mines," then section 59-2-102(24) defines "mine" to mean "a natural deposit of either metalliferous or nonmetalliferous *valuable* mineral." (emphasis added). Thus, both the Constitution and statutes require the Tax Commission to impose tax uniformly on all minerals with value. The Tax Commission has determined that the best way to separately value and tax minerals in a uniform manner is to (1) value and tax oil and gas after a well is drilled and the minerals become "developed reserves" (*see* Tax

Commission Appeal No. 03-0937), (if oil and gas have sufficient value, someone will presumably drill a well to tap into such value), and (2) value other minerals when they have become "proven reserves" or "probable reserves" (*see* Rule 7(B)(2)), which by definition means the reserves are "economic," *see* 17 CFR 229.801(g) (2015) and Industry Guide 7(a)(1).

Given the Constitutional and statutory requirements to uniformly assess and impose tax, there is no currently feasible means for the Tax Commission to uniformly find and separately value all *undeveloped* reserves in Utah. Thus the Tax Commission does not separately value them.[7] The map attached hereto as Exhibit C shows the vast reserves that the Utah Geologic Survey estimates are beneath our state. The map indicates that there is undeveloped coal underneath significant parts of Utah, along with various other undeveloped minerals throughout the state. The reserves are hidden, undiscovered, and of indeterminate value. To try to separately value all undeveloped reserves apart from the real property on a uniform basis is impractical because that would require finding and uniformly valuing all of the copper, oil, gas, salt, etc. under the land of every farmer, rancher, and other landowner in Utah. This is simply not feasible for either petroleum or minerals reserves for the following reasons. Petroleum reserves must be developed in order to determine the production and decline rates that underlie the projection of income streams necessary for financial valuation analysis. Mineral reserves must be proven or

[7] The Tax Commission disagrees with the District Court's characterization of undeveloped reserves as "akin to an intangible asset" "not subject to taxation." *See* Ruling and Order at p. 10, attached hereto as Exhibit D. Mineral reserves are clearly tangible. The Tax Commission does not value them because it cannot do so uniformly, not because they are intangible.

probable or, if part of a productive mine, otherwise valuable in a reasonably quantifiable manner in order to undertake financial valuation analysis.

At a preliminary stage of evaluation, similar properties may appear to contain similar reserves, but one may never start production because of issues discovered as it moves towards the development stage. It is simply not feasible for the Tax Commission to try to uniformly find and separately value all undeveloped reserves consistent with the requirements of the Utah Constitution and statutes. The Tax Commission must wait until the property owners establish the value with greater certainty as they put it into production before it separately values them. It is possible that the industry practices and technology will change in the future to allow different reliable criteria to be employed to determine when reserves can by uniformly taxed, but in the past and presently, the valuation practices described in this brief has been used.

Under current natural resource industry practices, reporting and Tax Commission staffing, it is not possible for the Tax Commission to separately value undeveloped reserves for property taxation purposes in a uniform manner.

DATED this 8th day of February, 2016.

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CERTIFICATE OF SERVICE

The undersigned certifies that two (2) true and correct copies of the foregoing *BRIEF OF UTAH STATE TAX COMMISSION AS AMICUS CURIAE ON BEHALF OF APPELLEES* was served this 8th day of February, 2016, in the following manner upon the addressees listed below:

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ADDENDA

EXHIBIT A

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NOV 16 2004

Holme, Roberts & Owen, LLP

BEFORE THE UTAH STATE TAX COMMISSION

Redacted Petitioner, Redacted , Petitioner, v. PROPERTY TAX DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	)	**ORDER DENYING RESPONDENT'S MOTION TO STRIKE AND/OR DISMISS AND GRANTING RESPONDENT'S MOTION FOR PARTIAL SUMMARY JUDGMENT** Appeal Nos. 03-0937 and 03-0963 Tax Type: Centrally Assessed / Property Tax Tax Year: 2003

Presiding: Pam Hendrickson, Commission Chair
R. Bruce Johnson, Commissioner
Kerry R. Chapman, Administrative Law Judge

Appearances:

Redacted :	Redacted	, Attorney at Law
	Redacted	Attorney at Law
	Redacted	, Redacted
For Redacted	Redacted	, Attorney at Law
	Redacted	Attorney at Law
For Respondent:	Redacted	Assistant Attorney General
	Redacted	Property Tax Division

STATEMENT OF THE CASE

This matter is before the Commission on Respondent's Motion to Strike and/or Dismiss or Motion for Partial Summary Judgment, filed by Property Tax Division ("Division") on February 4, 2004 and on its Errata to Motion to Strike and/or Dismiss or Motion for Partial Summary Judgment, filed on February 5, 2004 (collectively referred to as Division's "Motion"). On March 10, 2004, Redacted ") filed a Memorandum in Support of the

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Division's Motion to Strike and/or Dismiss or Motion for Partial Summary Judgment (Redacted "Support of Motion") and Redacted filed a Memorandum in Opposition to Property Tax Division's Motion to Strike and/or Dismiss or Motion for Partial Summary Judgment (Redacted "Opposition to Motion"). Other filings related to the Division's Motion included the Respondent's Reply Regarding its Motion to Strike and/or Dismiss or Motion for Partial Summary Judgment (Division's "Reply Regarding Motion"), filed by the Division on March 30, 2004; Redacted Memorandum in Opposition to Redacted Resources' Memorandum Supporting Motion to Strike and/or Dismiss or Motion for Partial Summary Judgment (Redacted "Opposition to Supporting Motion") and the Affidavit of Eckhardt Arthur Prawitt, both filed by Redacted on March 31, 2004; and Redacted Reply Memorandum in Support of the Division's Motion to Strike and/or Dismiss or Motion for Partial Summary Judgment (Redacted "Reply Supporting Motion"), also filed on March 31, 2004. A Hearing on the Respondent's Motion was held on April 14, 2004.

Two appeals have been filed in this matter, both brought before the Commission to contest the value at which the Division assessed oil and gas property owned by Redacted for the 2003 tax year. Redacted (Appeal No. 03-0937) contends in its Objection and Petition for Redetermination ("Petition") that the fair market value of Redacted centrally assessed property is higher than the Division's assessed value, while Redacted (Appeal No. 03-0963) contends that the Division assessed the value too high. Although Redacted Petition lists a number of reasons why the Division failed to assess the fair market value of all taxable tangible property owned by Redacted inherent in its appeal (as later discussed) is the implication that the

Division did not properly attribute value to Redacted oil and gas reserves not in development or for which a plan of production did not exist (hereinafter referred to as "undeveloped reserves") as of the January 1, 2003 lien date. In defense or objection to this position, the Division filed the Motion at issue.

In its Motion, the Division argues that, in its appraisals, it never attempted to incorporate a method or technique that specifically measures the effect of undeveloped reserves of an oil and gas company when determining, for assessment measures, the fair market value of its taxable tangible property. Furthermore, the Division argues that should it be required to do so, administrative and equalization issues would arise for which it knows no solution. For these reasons, the Division asks the Commission to uphold its current practice and to rule that Utah law permits it to assess a centrally assessed oil and gas company without employing an appraisal method that measures the impact of the assessed property's undeveloped reserves. The Division Motion requests that the ruling be issued in an Order to Strike, an Order to Dismiss, or an Order for Partial Summary Judgment. Redacted supports the Division's request for the Commission to address this issue prior to an evidentiary hearing on Redacted assessed value.

Redacted contends the Commission may not grant any portion of the Division's Motion because it failed to set forth adequate legal and factual grounds for such relief under the Utah Rules of Civil Procedure ("URCP"). In addition, Redacted contends that an evidentiary hearing is necessary to determine material facts at issue and that the Commission must deny the Division's Motion in order to afford the county its right to due process of law.

APPLICABLE LAW

There are a number of legal authorities discussed in this Order, which are segregated into two categories for easier reference. Authorities relating to motions, administrative law and other procedural issues are listed under "Motions and Administrative Law," while authorities relating to the taxation of oil and gas property are listed under "Taxation of Property".

I. MOTIONS AND ADMINISTRATIVE LAW.

A. Utah Rules of Civil Procedure. In defense of a claim, Rule 12(b) of the URCP ("Rule 12(b)") provides that a party may request by motion an Order of Dismissal for:

> (1) lack of jurisdiction over the subject matter, (2) lack of jurisdiction over the person, (3) improper venue, (4) insufficiency of process, (5) insufficiency of service of process, (6) failure to state a claim upon which relief can be granted, (7) failure to join an indispensable party. If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

Rule 12(f) of the URCP ("Rule 12(f)") provides that, upon receiving a motion to strike, a "court may order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter."

Rule 56 of the URCP ("Rule 56") provides that a party defending a claim may file a motion for summary judgment in whole or part and that summary judgment may be rendered, as follows:

> . . .
> (b) For defending party. A party against whom a claim, counterclaim, or cross-claim is asserted . . . may, at any time, move with or without supporting affidavits for a summary judgment in his favor as to all or any part thereof.
> (c) Motion and proceedings thereon. The motion, memoranda and affidavits shall be filed and served in accordance with CJA 4-501. The judgment sought shall be rendered if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. . . .
> (d) Case not fully adjudicated on motion. If on motion under this rule judgment is not rendered upon the whole case or for all the relief asked and a trial is necessary, the court at the hearing of the motion, by examining the pleadings and the evidence before it and by interrogating counsel, shall if practicable ascertain what material facts exist without substantial controversy and what material facts are actually and in good faith controverted. It shall thereupon make an order specifying the facts that appear without substantial controversy . . . and directing such further proceedings in the action as are just. Upon the trial of the action the facts so specified shall be deemed established, and the trial shall be conducted accordingly.
> . . . .

Rule 7 of the URCP ("Rule 7") addresses pleadings, motions, and orders associated with a civil trial. Prior to November 1, 2003, Rule 7(b)(1) provided that "an application to the court for an order shall be by motion which . . . shall be made in writing, shall state with particularity the grounds therefore, and shall set forth the relief or order sought." Effective November 1, 2003, however, Rule 7 was amended and now contains specific requirements concerning a motion for summary judgment, as follows:

> . . . .
> (b) Motions. An application to the court for an order shall be by motion which . . . shall be made in accordance with this rule. A motion shall be in writing and state succinctly and with particularity the relief sought and the grounds for the relief sought.

> (c) Memoranda.
> (c)(1) Memoranda required, exceptions, filing times. All motions, except uncontested or ex parte motions, shall be accompanied by a supporting memorandum. . . .
> . . . .
> (c)(3) Content.
> (c)(3)(A) A memorandum supporting a motion for summary judgment shall contain a statement of material facts as to which the moving party contends no genuine issue exists. Each fact shall be separately stated and numbered and supported by citation to relevant materials, such as affidavits or discovery materials. Each fact set forth in the moving party's memorandum is deemed admitted for the purpose of summary judgment unless controverted by the responding party.
> (c)(3)(B) A memorandum opposing a motion for summary judgment shall contain a verbatim restatement of each of the moving party's facts that is controverted, and may contain a separate statement of additional facts in dispute. For each of the moving party's facts that is controverted, the opposing party shall provide an explanation of the grounds for any dispute, supported by citation to relevant materials, such as affidavits or discovery materials. For any additional facts set forth in the opposing memorandum, each fact shall be separately stated and numbered and supported by citation to supporting materials, such as affidavits or discovery materials.
> . . . .

B. Utah Code Annotated. UCA §63-46a-12 of the Utah Administrative Rulemaking Act provides that an interested party may petition an agency to make, amend, or repeal an administrative rule and that "the agency shall either deny the petition in a writing stating its reasons for the denial, or initiate rulemaking proceedings in accordance with Section 63-46a-4."

All state agency actions, except as specified, are governed by the Utah Administrative Procedures Act ("UAPA"), as found in Sections 63-46b-1 through –23 of the Utah Code Annotated. UCA §63-46b-1 provides as follows:

> . . . .
> (4) This chapter does not preclude an agency, prior to the beginning of an adjudicative proceeding, or the presiding officer during an adjudicative

> proceeding from: . . . (b) granting a timely motion to dismiss or for summary judgment if the requirements of Rule 12(b) or Rule 56 of the Utah Rules of Civil Procedure are met by the moving party, except to the extent that the requirements of those rules are modified by this chapter.
>
> . . . .
>
> (6) This chapter does not preclude an agency from enacting a rule affecting or governing an adjudicative proceeding or from following the rule, if the rule is enacted according to the procedures outlined in Title 63, Chapter 46a, Utah Administrative Rulemaking Act, and if the rule conforms to the requirements of this chapter.

An administrative agency may take "official notice" of certain facts not otherwise in the record as set forth in Utah Code Ann. §63-46b-8(1)(b), which provides that:

> "[o]n his own motion or upon objection by a party, the presiding officer . . . (iv) may take official notice of any facts that could be judicially noticed under the Utah Rules of Evidence, of the record of other proceedings before the agency, and of technical or scientific facts within the agency's specialized knowledge."

C. Utah Administrative Rules. The Tax Commission has enacted rules addressing the content and format of requests for administrative action and motions. Utah Admin. Rule R861-1A-22 establishes the requirements for a petition to commence adjudicative proceedings before the Commission, as follows:

> . . . .
>
> B. Contents. A petition for adjudicative action need not be in any particular form, but shall be in writing and, in addition to the requirements of Utah Code Ann. Section 63-46b-3, shall contain the following:
>
> . . . .
>
> 4. particular tax or issue involved, period of alleged liability, amount of tax in dispute, and, in the case of a property tax issue, the lien date;
>
> . . .; and
>
> 6. in the case of property tax cases, the assessed value sought.
>
> C. Effect of Nonconformance. The commission will not reject a petition because of nonconformance in form or content, but may require an amended or substitute petition meeting the requirements of this section when such defects are present. An

> amended or substitute petition must be filed within 15 days after notice of the defect from the commission.

Utah Admin. Rule R861-1A-26, which establishes procedures for formal adjudicative proceedings before the Commission, specifically addresses motions in Section (F), as follows:

> . . . .
> 4. Ruling on Procedural Motions. Procedural motions may be made during the hearing or by written motion.
> a) Each motion shall include the grounds upon which it is based and the relief or order sought. Copies of written motions shall be served upon all other parties to the proceeding.
> b) Upon the filing of any motion, the presiding officer may:
> (1) grant or deny the motion; or
> (2) set the matter for briefing, hearing, or further proceedings.

D. Utah Rules of Evidence. Rule 201(b) of the Utah Rules of Evidence ("URE") provides that a "judicially noticed fact must be one not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned."

II. TAXATION OF PROPERTY.

A. The Utah State Constitution provides for the taxation of tangible property in the state. Specifically, Utah Const. art. XIII, §2(1) provides as follows:

> . . . all tangible property in the State that is not exempt under the laws of the United States or under this Constitution shall be (a) assessed at a uniform and equal rate in proportion to its value, to be ascertained as provided by law; and (b) taxed at a uniform and equal rate.

Furthermore, Utah Const. art. XIII, §3 provides the authority to exempt certain tangible property from property tax in Utah. This section, however, contains no provision that specifically exempts any type of oil and gas reserves from taxation.

B. Utah Code Annotated. Pursuant to the Constitutional requirement to tax tangible property at its fair market value, the Legislature enacted Utah Code Ann. §59-2-103, which provides as follows:

> (1) All tangible taxable property shall be assessed and taxed at a uniform and equal rate on the basis of its fair market value, as valued on January 1, unless otherwise provided by law.

The assessment of oil and gas properties is governed by Utah Code Ann. §59-2-201. Subsection 59-2-201(1)(e) provides that the Tax Commission shall assess at 100% of fair market value "all mines and mining claims except in cases, as determined by the commission, where the mining claims are used for other than mining purposes. . . ." Furthermore, Subsection 59-2-201(3) provides that:

> The method for determining the fair market value of productive mining property is the capitalized net revenue method or any other valuation method the commission believes, or the taxpayer demonstrates to the commission's satisfaction, to be reasonably determinative of the fair market value of the mining property. . . .

C. Utah Administrative Code. The Utah State Tax Commission ("USTC") adopted Utah Admin. Rule R884-24P-10 ("Rule 10") to help administer the assessment and taxation of oil and gas properties for purposes of UCA §59-2-201. Section (C) of Rule 10 provides that:

> . . .
>
> 2. The taxable value of underground oil and gas rights shall be determined by discounting future net revenues to their present value as of the lien date of the

> assessment year and then subtracting the value of applicable exempt federal, state, and Indian royalty interests.
> 3. The reasonable taxable value of productive underground oil and gas rights shall be determined by the methods described in C.2. of this rule or such other valuation method that the Tax Commission believes to be reasonably determinative of the property's fair market value.
> . . . .

ANALYSIS

In its Petition, Redacted claims that the Division improperly assessed Redacted centrally assessed oil and gas properties for the 2003 tax year and asserts that the assessed value should be $Red million, a value much higher than the $Reda million value at which the Division assessed Redacted for 2003 (as reported by the Division in its Errata to Motion[1]). Redacted states in its Support of Motion that, in a 2002 transaction, it paid $Red million for oil and gas rights that included rights in Redacted. Although the sales price represented the purchase of oil and gas reserves in development or for which a plan of production existed as of the 2003 lien date (hereinafter referred to as "developed reserves"), both Redacted and the Division assert in their respective filings that a portion of the $Red million sales price was attributable to undeveloped oil and gas reserves.

In its Opposition to Supporting Motion, Redacted includes its Exhibit A, a January 30, 2003 letter from Redacted. to Redacted Resources Corporation[2]

1 Both Redacted and Redacted report Redacted 2003 assessed value to be approximately $Re million, $R million less than the Division's reported value. Redacted explains in its Support of Motion that the discrepancy is due to wells owned by Redacted, but operated by and assessed to other entities.

2 Redacted is a company related to the Petitioner Redacted Redacted filed memoranda under both names in these proceedings, but has clarified that the latter company is one that should be considered the Petitioner.

("Redacted letter") that lends support to Redacted and the Division's assertions that a portion of the $Red million sales price was attributable to undeveloped reserves. Specifically, the Redac ted letter refers to its review of Redacted $Reda million estimate of net proved reserves attributable to its leasehold and royalty interests in Redacted as of December 31, 2002. The Redacted letter indicates that the $Reda million of "total proved reserves" has been apportioned $Reda million to "proved developed reserves" and $Reda million to "proved undeveloped reserves."

Without an evidentiary hearing, however, the Commission cannot find that any of these values is representative of the fair market value of tangible property. Nevertheless, the way the parties have used this information in their pleadings and responses indicates to the Commission that Redacted has asserted that a value must be ascribed to Redacted undeveloped reserves when the Division determines the fair market value of its taxable property for assessment purposes. The Commission further sees that Redacted is proposing a valuation method or technique that may measure all or a portion of the effect on value of undeveloped reserves. Although the assertion was not explicit in Redacted pleadings, the Commission determines that it is an inherent part of the county's claim for relief for the following reasons. First, Redacted had pleaded that Redacted taxable value is $Red million. As Redacted has submitted an exhibit indicating that Redacted developed reserves are valued at less than $Red million (Redacted letter), it becomes apparent that Redact ed is claiming that Redacted assessed value must also include a value ascribed to all or a portion of its undeveloped reserves.[3] In addition, in its Opposition to Supporting Motion, Redacted states that "discovery would be needed to quantify exactly the value based on all the proved reserves." The Redacted letter, as well as other information before the Commission as discussed herein, shows that "proved reserves" includes "proved undeveloped reserves." From this information, the Commission concludes that Redacted Petition contains a claim that, for assessment purposes, Redacted fair market value for the 2003 tax year must be derived using a valuation method that measures the impact of its undeveloped reserves.

As the Respondent to Redacted claim for relief, the Division has filed its Motion in defense or in objection of Redacted position. In its Motion, the Division explains that it has never attempted to use valuation techniques or appraisal methods that attribute specific values to undeveloped reserves when assessing an oil and gas company's taxable property and requests that its long-standing practice be maintained. For these reasons, the Division has requested the Commission to rule whether the Division is required or permitted to use appraisal methods that specifically measure the effect of Redacted undeveloped reserves on property value for assessment purposes. The Division requests the ruling under any one of three separate motions it has filed: 1) a Rule 12(f) motion to strike; 2) a Rule 12(b) motion to dismiss, or 3) a Rule 56 motion for partial summary judgment.

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3 Although Redacted originally asserted in its Petition that Redacted taxable value was $Re million, it asserted in its Opposition Supporting Motion that its taxable value is far greater than $Re million. In either case, the asserted value is greater than the value of proved developed reported in the Redacted letter, as submitted by Redacted.

I. MOTION TO STRIKE. Rule 12(f) of the URCP provides that a "court may order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter." Citing this rule, the Division has requested the Commission to strike those portions of Redacted Petition that relate to the taxation of undeveloped reserves. However, in none of its filings did the Division discuss how Redacted pleadings specifically violate the provisions of Rule 12(f). Of the three motions made by the Division, the Rule 12(f) motion to strike is the only one Redacted did not offer arguments against, stating that the Division's motion failed to identify how its Petition violated this particular rule. In addition, this is the only motion that Redacted did not discuss in its response memoranda.

The Commission, on its own review of Redacted pleadings, does not see any redundant, impertinent, or scandalous matter for which an Order to Strike might be appropriate. As discussed above, the Commission considers Redacted Petition to contain a claim that the value of Redacted undeveloped reserves should be measured and included in its assessment for the 2003 tax year. However, when the legality of the claim is still at issue, as it is here, the Commission does not consider such a claim to be an insufficient defense or an immaterial matter until the legal matter is resolved. For these reasons, the Commission does not find a basis to strike any portion of Redacted pleadings under Rule 12(f) and, accordingly, denies the Division's motion to strike.

II. MOTION TO DISMISS. In its second of three motions, the Division requests that the Commission issue an Order of Dismissal under Rule 12(b) of the URCP, which lists seven circumstances where it is appropriate to dismiss a claim. However, the Division neither states nor discusses which of the Rule 12(b) defenses should result in an Order of Dismissal. Nevertheless, both Redacted and Redacted found the Division's motion to be sufficiently clear that they each responded to Rule 12(b)(6), which provides for dismissal when a petitioner fails to state a claim for which relief can be granted. The Commission has reviewed the various defenses available under Rule 12(b) and, given the context of the circumstances and the legal ruling requested, also finds that the Division is specifically seeking an Order to Dismiss under Rule 12(b)(6).

In ruling on a Rule 12(b)(6) motion to dismiss for failure to state a claim, the Commission is required to view Redacted complaint "in the light most favorable to [Redacted] and indulge all reasonable inferences in [its] favor." *Mounteer v. Utah Power & Light Co.*, 823 P.2d 1055 (Utah 1991). The Commission is also required to "accept the material allegations of Redacted] complaint as true" and only issue an Order of Dismissal "if it clearly appears that [Redacted] can prove no set of facts in support of [its] claim." *Colman v. Utah State Land Bd.*, 795 P.2d 622 (Utah 1990).

The underlying issue in the Division's Motion is a legal question, specifically whether, under Utah law, Redacted fair market value for the 2003 tax year must be based on an appraisal method that ascribes a value to its undeveloped oil and gas reserves. If so, Redacted may be entitled to relief, assuming its allegations all to be true. As this legal question is still in dispute, however, it is not yet known whether relief would be available to Redacted, even if all its allegations were true. For these reasons, it is premature to grant a Rule 12(b)(6) motion to dismiss for failure to state a claim for which relief is available.

In addition, the Commission has received and considered information concerning this taxation issue that was not part of Redacted pleadings (see discussion on Motion for Partial Summary Judgment below). When matters outside the pleadings have been received and not excluded, Rule 12(b) provides that the motion for failure to state a claim for which relief can be granted should instead be treated as a motion for summary judgment.[4] Because the Commission has, in fact, chosen to treat the Division' Motion as a motion for partial summary judgment, it may not issue an Order to Dismiss under 12(b)(6). For these reasons, the Commission denies the Division's motion to dismiss under Rule 12(b).

III. MOTION FOR PARTIAL SUMMARY JUDGMENT. The Division's third and last motion is for partial summary judgment. UCA §63-46b-1(4) specifically requires an administrative agency to determine if a party moving for summary judgment has met the requirements of Rule 56 of the URCP before granting its motion. Rule 56(b) permits a party against whom a claim has been asserted to move for summary judgment in its favor. As the Respondent to Redacted claims, the Division is a party entitled under Rule 56(b) to "move with or without supporting affidavits for a summary judgment in [its] favor as to all or any part thereof." In its Motion, the Division has moved for the Commission to issue summary judgment on that part of Redacted claim that pertains to the valuation method applicable to undeveloped oil and gas reserves.

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4 See also *Thayne v. Beneficial Utah, Inc.*, 874 P.2d 120 (Utah 1994), which provides that "once matters outside the pleadings were presented to and not excluded by the trial court, the [URCP Rule 12(b)(6)] motion was properly treated as one for summary judgment."

"The sole purpose of summary judgment is to bar from the courts unnecessary and unjustified litigation." *Reliable Furn. Co. v. Fidelity & Guar. Ins. Underwriters*, 16 Utah 2d 211, 398 P.2d 685 (1965). An evidentiary hearing is necessary for the Commission to determine the value of Redacted **taxable** oil and gas property. If, however, certain aspects of oil and gas property need not be quantified when determining a company's fair market value for assessment and taxation purposes, an evidentiary hearing to determine the value of such property would be unnecessary. For these reasons, the Division requests that the Commission address in partial summary judgment, prior to an evidentiary trial, whether it is legally required to measure the effect or impact of undeveloped reserves in its appraisal methods when establishing the fair market value of Redacted taxable property. Redacted also supports this motion and expresses a desire not to commit the time and expense necessary to appraise and litigate the value of undeveloped reserves should such appraisal methods not be legally required. Redacted, on the other hand, contends that an evidentiary hearing is necessary to prove that a fair market value can be established that ascribes value to Redacted undeveloped reserves, in addition to its other reserves, and argues that a grant of partial summary judgment on this legal issue would deprive it of its right to due process.

Under Rule 56(d), the Commission is allowed to consider a grant of partial summary judgment for a single issue in the case, while reserving the other factual and legal issues for a formal evidentiary proceeding. For the Commission to grant the relief sought in the Division's motion for partial summary judgment, Rule 56(c) requires it to make two determinations: (A) a determination that the legal question posed by the Division is an appropriate matter to address in partial summary judgment (i.e., there exists no genuine issue of a material fact needed to answer it); and (B) a determination of the legal question itself, in this case, whether the Division is required to employ an appraisal method that specifically measures the effect of undeveloped reserves in setting Redacted assessed value for the 2003 tax year.

If a material fact needed to answer the legal question is genuinely at issue, then the Commission must deny the motion for partial summary judgment and reserve the matter for the formal proceeding. If, on the other hand, there is no genuine issue of any material fact, the Commission may proceed and answer the legal question now. Of course, a determination that the matter is appropriate to address in partial summary judgment only guarantees that the Commission will decide the legal question posed. It does not guarantee the Division the relief it seeks.

However, prior to determining whether partial summary judgment is appropriate in this matter under the provisions of Rule 56, we should first address Redacted argument that the Division's motion for partial summary judgment should be denied because the motion's content and format do not meet the requirements of URCP Rule 7(c)(3)(A). URCP Rule 7(c)(1) provides that most motions, including those for summary judgment, be accompanied by a supporting memorandum. Rule 7(c)(3)(A) specifically requires a memorandum supporting a motion for summary judgment to "contain a statement of material facts as to which the moving party contends no genuine issue exists." Furthermore, it requires that "[e]ach fact shall be separately stated and numbered and supported by citation to relevant materials, such as affidavits or discovery materials. . . ."

The Division's motion for partial summary judgment, while describing various facts that relate to the legal question at issue, includes neither a statement of separately numbered material facts as to which it contends no genuine issue exists nor any materials to support its statement of facts. It is clear that the Division's motion does not comply with the content and format provisions described in Rule 7(c)(3)(A). In its Opposition to Motion, Redacted claims that Rule 7(c)(3)(A) "absolutely mandates" a memorandum supporting summary judgment to contain the specific content and be in the specific format prescribed by the rule. The Division's noncompliance with Rule 7(c)(3)(A) is one reason, Redacted contends, why the Division fails to meet its burden on motion for partial summary judgment and why the Commission must deny the motion.

In the administrative appeals process, the Commission is aware that a uniform set of procedural rules promotes efficiency and clarity and provides all parties a known standard for preparing and filing documents relating to their appeals. However, the appeals process at an administrative agency such as the Tax Commission involves a wide variety of appeal issues, from relatively simple ones such as interest refund requests involving several dollars to complex issues involving intricate legal theories and millions of dollars of taxes. Not surprisingly, the parties that appear before the Commission in the appeals process are also as varied, from the pro se petitioner with little or, oftentimes, no knowledge of legal procedures to experienced and capable attorneys who regularly represent clients before the Commission and who have intimate knowledge of the procedures set forth in the URCP.

The Commission encourages, whenever practicable, all parties with administrative appeals before this agency to comply with the rules provided in the URCP to better guarantee not only the clarity of its pleadings and arguments, but also a general efficiency of process. Such clarity and efficiency is particularly important in cases with complex procedural and substantive issues, such as the appeals at issue in this matter. On the other hand, the taxpayers of Utah would be ill-served were the Commission to deny ordinary citizens who could neither navigate the URCP on their own nor afford legal representation to do so on their behalf the right to address their tax matters. Fortunately, the Tax Commission, as an administrative agency, has some flexibility when determining whether parties appearing before it must met all requirements set forth in the URCP.

The Utah Supreme Court has also recognized the flexibility that an administrative agency needs when applying the provisions of the URCP. "While the mode of procedure before administrative bodies may conform to the Utah Rules of Civil Procedure, the rules governing civil procedure in the trial courts are not necessarily applicable to administrative proceedings. Thus, administrative proceedings are not subject to the Utah Rules of Civil Procedure unless the governing statute or regulations so provide." *Pilcher v. Department of Social Servs.*, 663 P.2d 450 (Utah 1983).

Redacted argues that the Division's motion does not meet the specific requirements set forth in Rule 7 of the URCP, one of several rules in the URCP pertaining to the content and format of pleadings, motions, and orders submitted to or issued by a court of law.

However, while the UAPA and the Commission have both adopted several specific rules in the URCP that must be met in all proceedings before the Tax Commission, Rule 7 is not one of them.

Furthermore, many provisions of the UAPA (including UCA §§63-46b-3, 5, 6, and 9-13) contain specific content and format requirements for requests for action, pleadings and orders that apply in Utah's administrative proceedings. We note that these requirements are unique and, generally, less stringent than those found in the URCP. So too are the specific content requirements adopted by the Commission in Utah Admin. Rules R861-1A-22(B) (which lists specific content requirements for a petition for adjudicative action before the Commission and states that a petition need not be in any particular form) and R861-1A-26(F)(4)(a) (which provides that a motion before the Commission shall include the grounds upon which it is based and the relief or order sought). Because an administrative agency has some latitude concerning its application of the URCP and because the UAPA and the Commission have not specifically adopted Rule 7, the Commission finds that it is not required to deny the Division's motion because it failed to meet the requirements of Rule 7. Instead, the Commission finds that the Division's motion sufficiently set forth the issue, the grounds upon which it was based, and the relief sought and, accordingly, was a motion adequate in content and format for purposes of an administrative proceeding before the Commission.

The Commission recognizes that UCA §63-46b-1(4) specifically requires a motion for summary or partial summary judgment to meet the requirements of Rule 56 before it is granted. However, the Commission does not believe that this specific reference to Rule 56 subjects an administrative proceeding to all the procedural rules found in the URCP that may relate to summary judgment, including the specific content and format requirements of Rule 7. In addition, we note that Rule 56 make no reference to Rule 7. For these reasons, the Commission believes that, if the Division's motion satisfies the specific requirements of Rule 56, Section 63-46b-1(4) has also been satisfied, thereby authorizing it to address the matter in partial summary judgment. Accordingly, we proceed to determine whether the motion satisfies Rule 56.

A. Summary Judgment - Is there a genuine issue of any material fact needed to answer the legal question?

The Division and Redacted both contend that there is no genuine issue of a material fact required to answer the legal question in this matter; i.e., whether the valuation for Redacted assessment for the 2003 tax year must incorporate a methodology that measures the effect of undeveloped reserves. Both of these parties assert that, in compliance with Utah law and the Division's historical application of Rule 10, the Division did not ascribe value to any undeveloped reserves in Utah for the 2003 tax year, including those owned by Redacted Both the Division and Redacted further assert that Redacted Petition, if fully granted, would ascribe value to Redacted undeveloped reserves. Redacted contends that, were this to occur, it would be the only centrally assessed taxpayer in Utah to be assessed or valued on this basis, a violation of the uniform and equal assessment and taxation provisions of the Utah Constitution.

The Commission is required to deny the motion if Redacted shows that there is a genuine issue of a material fact necessary to answer the legal question. In its Opposition

Supporting Motion, Redacted separately stated and numbered additional facts it claims to be in dispute and offered, as evidence to support its assertion, an affidavit prepared by Eckhardt Arthur Prawitt. In these documents, Redacted claims that evidence will show that the fair market value of Redacted total proved reserves (both developed reserves and undeveloped reserves) is greater than the Division's assessed value for these reserves and that the Division did not properly apply the discounted cash flow ("DCF") formula in Rule 10 when determining a value for Redacted The Commission agrees with Redacted that there are genuine issues of fact regarding the value of Redacted total reserves, how much of the total value would be attributable to developed reserves as opposed to undeveloped reserves, and whether the Division properly applied the Rule 10 DCF formula when it made its assessment of Redacted Nevertheless, these facts are not necessary to answer the legal question before the Commission on the motion for partial summary judgment.

The legal question before the Commission is whether Redacted assessed value for the 2003 tax year must be based on an appraisal method that specifically measures the impact of its undeveloped reserves. The answer to this question is not dependent on the determination of a value for total reserves or a value for the undeveloped reserves alone. Even if reserves have an impact that can be ascertained, that effect cannot be incorporated into the assessment unless permitted under the law. Certainly, it cannot be denied that Redacted has clearly stated the facts it claims to still be in dispute and supplied evidence in the form of an affidavit to support these claims. However, although the facts Redacted claims to be material to answer the motion for partial summary judgment may be genuinely at issue and relevant to the value of

Redacted property, these facts are not material to determine whether Redacted assessed value must be derived using a valuation method that measures the impact of its undeveloped reserves. For these reasons, the facts relevant to determining the specific values of Redacted total taxable property and its various reserves have no impact on the motion.

In its assessment of oil and gas properties in Utah, the Division contends that it has historically, including the 2003 tax year, only measured the income stream of developed oil and gas reserves, by employing the discounted cash flow method prescribed in Rule 10. The Division states that it has not attempted to take into account the impact of undeveloped reserves owned by <u>any</u> centrally assessed oil and gas entity, including Redacted Should Redacted 2003 assessment process be changed to consider an effect attributable to its undeveloped reserves, it would be the <u>only</u> centrally assessed taxpayer assessed and taxed on this basis for the 2003 tax year. Redacted also contends that these statements are true, while Redacted has chosen not to address the veracity of these specific facts other than to say the Division has not proven them sufficiently to allow for summary judgment.[5] These facts, however, are material ones needed for the Commission to address the issue under one of two legal theories: (1) whether the uniformity requirements of Utah law forbid the assessment and taxation of Redacted oil and gas property for the 2003 tax year using a valuation methodology that measures the impact of its undeveloped

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5 In its Opposition to Motion and Opposition to Supporting Motion, Redact claims that because the other parties did not set forth facts supported by the record or other evidentiary materials, as required by Rule 7(c)(3)(A), there are no facts to controvert. In addition, at the hearing, Redacted counsel stated that he did not know if these facts claimed by the Division are true because the Division did not submit affidavits as evidence in support of these facts. We also note that Rule 56 specifically provides that the submission of affidavits by the party moving for summary judgment is optional.

reserves; or (2) whether current Utah law forbids the assessment and taxation of oil and gas property owned by all centrally assessed taxpayers using a valuation methodology that measures the impact of undeveloped reserves. The parties need not agree that there are no genuine issues of a material fact for the Commission to determine whether the matter is appropriate for summary judgment. However, the Commission may not make this decision unless, upon an examination of all evidence, including a consideration of the arguments given and responses to questions answered by the parties' respective counsel at the hearing, it determines that no material fact has been genuinely controverted.

We have received no evidence to suggest that the material facts set forth by the Division and Redacted are not true, especially as Redacted has not attempted to disprove them. However, the Division did not provide affidavits or other evidence to support these facts. A summary judgment must be supported by evidence that, when viewed in the light most favorable to the losing side, establishes that there is no genuine issue as to any material fact. *Bihlmaier v. Carson*, 603 P.2d 790 (Utah 1979). Therefore, the Commission believes it must exercise caution before concluding that the evidence on the record is sufficient to deprive Redacted the privilege of an evidentiary trial on the legality of considering the appraisal impact of undeveloped reserves. For these reasons, the Commission is taking official notice of the information found in the Rule 10 administrative record retained for public inspection and other information, as discussed below, relating to the assessment of oil and gas reserves.

Pursuant to UCA §63-46a-2 and Utah Admin. Rule R15-1-1(5), an agency must retain for public inspection the "administrative record" associated with each rule it enacts.[6] In Subsection 63-46a-2(1), the "administrative record" is defined as "information an agency relies upon when making a rule" and should include, among other items, the proposed rule or rule change, the public comment received during the comment period, and the agency's response to and analysis of such comment. The Commission has maintained for public inspection an administrative record pertaining to Rule 10 that contains these items.

In UCA §63-46b-8(1)(b)(iv), the UAPA provides that an administrative agency "may take official notice of any facts that could be judicially noticed under the Utah Rules of Evidence, of the record of other proceedings before the agency, and of technical or scientific facts within the agency's specialized knowledge." The administrative record for Rule 10 is a public record containing the rulemaking proceedings relating to that rule and, in accordance with Section 63-46b-8(1)(b)(iv), the Commission takes official notice of the administrative record.[7]

6 In Subsection (5)(d) of Utah Admin. Rule R15-1-1, the Utah Division of Administrative Rules establishes that "[t]he hearing record shall be kept with and as part of the rule's administrative record in a file available at the agency offices for public inspection." While "administrative record" is defined in UCA §63-46a-2(1), "hearing record" is defined at Subsection (5)(b) of Rule R15-1-1 and consists of "a copy of the proposed rule or rule change, submitted written comment, the hearing recording or summary, the list of persons speaking at the hearing, and other pertinent documents as determined by the agency."

7 The Commission takes official notice of the contents of the administrative record for Rule 10 to establish what information was available to the Commission when it issued its 1992 amendment ruling. However, the Commission is not taking official notice that any statements of opinion or disputable facts contained in the documents comprising the administrative record are true, as the veracity of such information would require an evidentiary hearing to ascertain. Official notice of information for this latter purpose would be inappropriate.

The Rule 10 administrative record is a voluminous file, but a majority of the record is comprised of information relating to an amendment to the rule in 1992. Subsequent to a public hearing held in December 1991, the Commission adopted a proposed amendment to Rule 10 in February 1992 that changed the valuation method for assessing oil and gas properties in Utah from one based on "net proceeds" to one based on a DCF model (effective for the 1992 tax year). The administrative record contains dozens of letters and memoranda containing comments from parties both in support of and against this proposed rule amendment.

Not only do these records give insight into the historical assessment of oil and gas properties in Utah, but they also describe the confluence of factors that resulted in the 1992 rule amendment. The administrative record also shows that the Commission knew, at the time of its 1992 ruling, that many parties considered Rule 10 flawed because it undervalued oil and gas properties by failing, among other reasons, to separately measure the value of undeveloped reserves. However, once the counties withdrew their objections to the proposed rule in early 1992, the Commission enacted the amendment at the behest of all interested parties. Furthermore, the Commission notes that the record contains no information to suggest that a party has subsequently petitioned for a rule amendment that would prescribe an appraisal method that would measure the value of undeveloped reserves for assessment purposes. A summary of relevant information as found in the Rule 10 administrative record to support these conclusions includes the following:

Information Available to the Public in the Rule 10 Administrative Record (references to the valuation of undeveloped reserves are in bold)

1896 – 1980's. Utah's Constitution initially provided that net proceeds would be the basis for valuing mining property. Although this provision was eliminated from the Constitution prior to 1941, oil and gas companies continued to be assessed using the net proceeds method until 1992. Until 1987, the statute regarding the valuation of oil and gas properties was silent as to what method of valuation should be employed. In 1987, the Legislature enacted UCA §59-2-201, which provided that the method to value the fair market value of productive mining property would be the capitalized net revenue method . . . ." However, even with the Constitution and statutory changes, the method of assessment prescribed in Rule 10 and used by the Division to value oil and gas properties throughout the 1980's remained the net proceeds method. (In administrative record, see Letter from Ron Perry to the Commission dated 12-9-91 ("Ron Perry Letter of 12-9-91") and Division Memo to the Commission dated 12-26-91).

1978. The 400% Formula. At least as far back as 1978, Rule 10 valued oil and gas properties at five times their net proceeds (which were assumed under the rule to be 80% of gross proceeds), using what was commonly referred to as the "400% Formula;" i.e., Value = (5) x (net proceeds) = (5) x (.8) x (gross proceeds) = (4) x (gross proceeds). A benefit of valuing oil and gas properties with this formula was the predictability of the taxpayers' tax costs and the taxing entities' tax revenues, as this valuation method was not severely impacted by future cash flows and price fluctuations. (See Ron Perry Letter of 12-9-91).

1983-1987. In 1983, the governor and legislature asked the Tax Commission to review the methodology for valuing all property. In 1984, a task force was organized to study the best methodology for valuing oil and gas wells. Meetings with the oil industry (and other parties) continued for several years, but were finally dropped in 1987, when no agreement could be reached. The Division had favored a DCF methodology at these meetings. (See Statement of Mike Monson, Director of Property Tax Division, at the 12-19-91 public hearing on Rule 10).

October 1985 and November 1986. The Division proposed that the Commission amend Rule 10 and replace the 400% Formula with a direct capitalization valuation method. The Division provided information suggesting that the 400% Formula was not related to "fair market value" and, thus, was indefensible in court. In a memo, Mike Monson indicated that the oil industry and an ad hoc committee established by former Tax Commissioner Gary Cornia would object to the direct capitalization approach because they supported a change to a DCF methodology instead.

January 5, 1987. The Commission sent a memo to the Division, informing it that the Commission would not submit the Division's proposed Rule 10 amendments that incorporated a direct capitalization formula to the Division of Administrative Rules ("DAR"). The Commission had indicated that it had given the Utah Petroleum Association assurance that it would not adopt the Division's proposed amended rule incorporating a direct capitalization method without first meeting with Gary Cornia's group to hear their concerns with the proposal.

1987. Section 59-2-201 was enacted by the Legislature in 1987 (effective 1/1/88), wherein subsection (3) provided that "[the] method for determining the fair market value of productive mining property is the capitalized net revenue method or any other valuation method the commission believes or the taxpayer demonstrates to the commission's satisfaction, to be reasonably determinative of the fair market value of the mining property." Prior to the enactment of this statute, Section 59-5-61 only required that owners of valuable hydrocarbon deposits file information concerning their property and its value with the Commission. (See Ron Perry Letter of 12-9-91).

1989. In 1989, Rule 10 was modified to state (new language underlined):

> The reasonable taxable value of productive underground oil and gas rights shall be determined by the [400% Formula] <u>or such other valuation method that the Tax Commission believes to be reasonably determinative of the property's fair market value</u>.

Oil companies began to challenge their property valuations, as determined with the 400% Formula, under the argument that there were other valuation methods that would better reflect their properties' fair market value. (See various documents that show that many oil and gas companies appealed their assessments for the 1989, 1990, and 1991 tax years. Other information obtained from a letter submitted on behalf of Utah Counties dated 11-13-91).

October 9, 1990. The Division submitted a proposed revision of Rule 10 to the Commission that employed a DCF model to value oil and gas companies instead of the 400% Formula. On January 31, 1991,the Commission informed the Division that it was rejecting its request for a rule change.

May 10, 1991. The Division again submitted a proposed revision of Rule 10 to the Commission, which would employ a DCF model to value oil and gas companies instead of the 400% Formula.

September 1991. The five oil producing counties (Redacted) and their school districts were advised that there had been a proposal to amend Rule 10 and the Tax Commission would shortly begin official consideration of the proposed changes, which, if adopted, would hopefully go into effect on January 1, 1992.

October 16, 1991. In a memo to the Commission addressing the fiscal impact of implementing a DCF valuation model, Mike Monson estimated that oil and gas property assessed values could be reduced in the worst case scenario or might remain the same in the best case scenario. But, he recommended the change because the Attorney General's Office had informed the Division there was a good chance the 400% Formula would be found to be unconstitutional because it was not related to "fair market value."

On this date, the Commission approved, for submission to DAR, a revision to Rule 10 incorporating a DCF model to assess oil and gas properties. On October 31, 1991, the Commission submitted the proposed amendments to Rule 10 to DAR.

October 31 – December 19, 1991. The Commission received comments from a number of parties both for and against the proposed amendment to Rule 10. Letters from the counties and school districts affected by the amended rule change encouraged the Commission not to adopt the proposed rule, but to endorse the 400% Formula instead.

Letters from various oil and gas companies and related organizations were received in support of the amendments to Rule 10. Among the parties supporting the rule amendments were the Utah Petroleum Association and most major oil and gas companies. Some of these companies included Amoco Corporation, Phillips Petroleum Company, Chevron USA, Inc., Meridian Oil, Inc., Mobil Exploration an Production North America, Southland Royalty Company, Texaco Exploration and Production, Inc., Union Pacific Resources Company, and Coastal Oil and Gas Corporation. These organizations stressed that the proposed amendment to Rule 10, incorporating a DCF valuation model, was the result of seven years of meetings between the companies, the counties, and the Division and that the current Rule 10 did not adhere to any of the three recognized methods of determining fair market value (i.e., cost, income, sales approaches).

In a letter submitted by Amoco Corporation in support of the rule amendment was a December 1986 publication entitled "The Salomon Brothers Oil and Gas Reserve Valuation Model: A Systematic Approach to the Valuation of Petroleum Reserves." The model in this document assumed that **"proved developed reserves"**

are to be developed until depleted and that "proved undeveloped reserves" are to be developed on a steady, straight-line basis over a ten-year period.

Hal Heaton, a professor at BYU, endorsed the proposed rule amendment, stating that the 400% Formula "probably has resulted in huge errors in its estimation of fair market value" and that "discounted cash flow is the consistently superior and most fundamental approach to valuation."

November 26, 1991. The Utah Association of Counties ("UAC") submitted a resolution requesting the Commission not to adopt the proposed Rule 10 amendments until the counties had time to evaluate whether the 400% Formula was supportable and if there were more viable alternatives than the DCF method.

December 9, 1991. Commissioner Ron Perry, Summit County Commissioner, on behalf of the Five County Oil and Gas Valuation Task Force ("County Task Force") (composed of representatives from the five oil producing counties, their respective school districts, and the Utah State Office of Education), submitted a letter opposing the proposed rule amendments.

In the letter, the County Task Force acknowledged that **the 400% Formula did not assess a value to either "proven but undeveloped reserves" or "undrilled leases" and commented that nothing in the Utah Constitution or Utah law prohibited the taxation of these assets.** Nevertheless, the County Task Force asked the Commission to forego the proposed amendments to Rule 10 and retain the 400% Formula, stating that it was a fair and predictable means to tax oil and gas properties. (Note that an unsigned draft of this document was also submitted to the Commission on November 13, 1991 and was provided as an exhibit in Redacted Reply Supporting Motion).

The County Task Force also argued that the proposed DCF method undervalued underground oil and gas deposits and lead to wide fluctuations in assessed values and tax dollars from year to year. In addition, **it criticized the proposed DCF model because it did not include cash flow from "predictable future drilling," i.e., proven but undeveloped reserves and undrilled leases.** The County Task Force stated that while its members had no philosophical objection to using a DCF model to value oil and gas properties, **any proposed rule change adopting such a valuation method should include a number of elements, including the valuation of undrilled leases and undeveloped reserves. The County Task Force argued that if value was estimated by projecting future cash flows, that estimate must include all future cash flows, including those that will come from assets not yet in production.**

The County Task Force also argued that the 400% Formula could be considered a "unitary" appraisal concept, which would estimate a value for all oil and gas properties, whether or not productive, while a DCF valuation concept would only value those properties for which revenue and cost information were analyzed.

December 10, 1991. In a letter received on behalf of Summit County, Redacted (counsel for Redacted in the present matter) requested an opportunity to speak and make a presentation at the public rule hearing on December 19, 1991, in opposition to the proposed rule. He included with his letter a copy of the document that the County Task Force submitted to the Commission. Again, included in this document were statements that the **"most comprehensive criticism of proposed Rule 10" is that it ignores undeveloped values and that an acceptable rule should contain a number of elements, including the "valuation of undrilled leases and undeveloped reserves."**

December 19, 1991. On this date, the public hearing was held on the proposed amendments to Rule 10. At the hearing, Howard Stephenson, on behalf of the Utah Taxpayers Association, spoke in favor of the proposed rule and "urge[d] the Commission to act now and to not hesitate in addressing this issue . . . [and to] settle this matter and not let it be drawn out in the courts."

Commissioner Ron Perry spoke on behalf of the County Task Force and urged the Commission to allow other valuation methods to be studied prior to adopting the proposed DCF amendments. He requested that this ruling not be put in effect for six months to allow the County Task Force time to answer unresolved questions. Others, including Redacted, as counsel for UAC and the County Task Force, spoke against the proposed amendments. Opponents argued that **the DCF method did not capture the effect of undeveloped leases** and expressed concern over losing as much as 60% of their oil and gas property tax value.

Prior to making a decision to adopt the proposed rule, the Commission allowed the parties seven days to submit additional information.

December 26, 1991. The Division submitted a memo to the Commission addressing the valuation of oil and gas properties in other states. The memo noted that of those states employing a valuation method similar to the 400% Formula (a gross or net proceeds method), only Utah did not have Constitution or statutory provisions calling for a valuation method based on a multiple or fraction of the gross or net proceeds. Utah's Constitution and statutory provisions more closely matched those of Texas, California, and Kansas, all of which employed a DCF or other similar valuation method to arrive at fair market value.

January 8, 1992. The Commission began informing interested parties that, after receiving input at the public hearing, it had decided to delay implementation of the proposed amendments to Rule 10 for a period not to exceed six months to allow the counties time to analyze and possibly suggest a better alternative to the DCF methodology in the proposed rule.

February 4–12, 1992. The Commission received letters from the taxing entities that had opposed the Rule 10 amendments (including Redacted , UAC, and the County Task Force), whereby they informed the Commission that they **were withdrawing their objections to the proposed amendments to Rule 10. The withdrawal of their objections were part of an agreement between the taxing entities and the oil and gas companies to settle property tax appeals pending for the 1989, 1990, and 1991 tax years. These letters also indicated that the taxing entities had agreed that the DCF valuation model, as proposed by the Division, should be used to value oil and gas companies for the 1992 tax year.** (Note: letters reciting terms of agreement between these parties are also included in the Rule 10 administrative record).

February 11, 1992. The Commission received a letter from Lyle Anderson, an attorney hired by Grand County and San Juan Co. School District. He alerted the Commission that while his clients had entered into the agreement to withdraw their opposition to the Rule 10 amendments, they did so with the **understanding that the taxing entities could conduct a study and would be given a fair hearing on their proposals to amend the rule further to address a number of issues, one of which would be "[o]btaining information that will permit valuation of proved developed and probable reserves, in addition to producing reserves."**

February 12, 1992. The Commission adopted the amendments to Rule 10, which replaced the 400% Formula with a DCF valuation model beginning with the 1992 tax year.

February 14, 1992. The Commission responded to Mr. Anderson, the attorney for Grand County, **welcoming the information the taxing entities' study would produce and informing him that administrative rulemaking procedures in Utah allowed any interested party to submit a request for a revision to an existing rule.**

November 13, 1992. Commission submitted proposed Rule 10 amendments to DAR that addressed the definitions of "product price," "production asset," and "costs," as used in the Rule 10 DCF model, to become effective for the 1993 tax year.

January 1, 1993. The amendments to definitions used in the DCF valuation model in Rule 10 became effective on this date. The provisions of Rule 10 have not subsequently changed, except for minor amendments in 1993 and 1994.

1993 - Present. There is no documentation in the Rule 10 administrative record to indicate that the counties or their representatives submitted proposed amendments to Rule 10 subsequent to the adoption of the DCF model in 1992 or that any party, for that matter, has provided subsequent studies concerning the valuation of oil and gas properties, including techniques that would capture the effect for proved undeveloped reserves or un-drilled leases.

The chronology and record of events regarding the implementation of Rule 10 shows that the Counties were not only aware that the DCF valuation model in Rule 10 would not measure the effect of undeveloped reserves for assessment purposes, but also that they tacitly acquiesced by withdrawing their objections and failing to support a different methodology thereafter.

In addition to the facts contained in the Rule 10 administrative record, the Commission has administrative familiarity with the assessment of oil and gas properties as the agency responsible for those assessments. As the agency given the powers and duties to administer and supervise the tax laws of this state, the Commission is aware and also takes official notice of the fact that value that might be attributable to undeveloped reserves has not been specifically accounted for in appraisal methods used in Utah under Rule 10. The Commission is also aware that there are multiple centrally assessed oil and gas entities other than Redacted that own undeveloped reserves in Utah. The knowledge of these facts that the Commission possesses through its experience in administering and supervising the assessment of oil and gas entities further reinforces the certainty of that knowledge that is found in the Rule 10 administrative record.

The following statement of facts (in underline) are the material facts needed to address, on the Division's motion for partial summary judgment, the legal issue of whether a valuation method that measures the effect of Redacted undeveloped oil and gas reserves is required or permitted for its assessment and taxation for the 2003 tax year and, although these facts are not admitted by all parties, are not genuinely controverted:

Statement of Facts

1. Under Rule 10, historically and including the 2003 tax year, the valuation model used to determine the fair market value of property owned by a centrally assessed oil and gas company, for assessment and taxation purposes, has measured the impact of value attributable to its developed oil and gas reserves, but has not measured the impact on value attributable to its undeveloped oil and gas reserves.

The Commission has participated in prior rulemaking proceedings regarding Rule 10 and, in 1992, formally adopted the DCF valuation method that is currently used to assess oil and gas properties in Utah. The Rule 10 administrative record clearly indicates that the Commission was aware, when it adopted the amendment in 1992, that this DCF model was not intended to measure the impact of undeveloped oil and gas reserves. The administrative record also shows that, since the 1992 amendment to Rule 10, no party has submitted, for the Commission to consider in the rulemaking process, studies examining other valuation methods that might measure the impact of undeveloped reserves. Nor has any party proposed amendments to Rule 10 that would provide for such methods. Given the information of which the Commission takes official notice, the assertions of the Division and Redacted lack of evidence to the contrary, the Commission finds this fact to be uncontroverted.

2. Redacted is a centrally assessed oil and gas company. For the 2003 tax year, the Division assessed Redacted oil and gas property using a methodology that measured the impact on value attributable to its developed reserves, but did not measure an impact of its undeveloped reserves.

Given the information of which the Commission takes official notice, the assertions of the Division and Redacted lack of evidence to the contrary, the Commission finds this fact to be uncontroverted.

3. There are numerous centrally assessed oil and gas entities in Utah that own undeveloped oil and gas reserves other than Redacted

The Commission has participated in many tax appeals with such entities. Given the information of which the Commission takes official notice, the assertions of the Division and Redacted lack of evidence to the contrary, the Commission finds this fact to be uncontroverted.

By deciding that the above facts are the ones material to answering the Division's legal question and finding that there exist no genuine issues of any of these facts, the Commission finds that the Division's motion for partial summary judgment on the legal question posed satisfies the requirements of Rule 56. Having determined the matter appropriate to address in partial summary judgment, we proceed to the second determination, the legal issue itself.

B. Legal Question – Is the Division required or permitted to apply a valuation method that measures the impact of Redacted undeveloped reserves for assessment and taxation purposes for the 2003 tax year?

The underlying issue in the Division's motion is whether the valuation methodology used to assess and tax Redacted property for the 2003 tax year must measure the effect of undeveloped reserves. As we have determined that this issue may be addressed in partial summary judgment instead of in an evidentiary proceeding, we proceed to address the issue regarding Redacted undeveloped reserves under the two legal theories proposed. These are: 1) would using a valuation methodology that measured the effect of undeveloped reserves to determine Redacted assessed value for the 2003 tax year violate Utah's uniform and equal assessment and taxation provisions, and, if not; 2) under Utah law in effect as the lien date, must a valuation methodology used to centrally assess oil and gas property measure the value attributable to undeveloped reserves.

Art. XIII, Sec. 2(1) of the Utah Constitution requires that all tangible property, not exempt under the laws of the United States or under the Utah Constitution, be assessed and taxed at a uniform and equal rate. The Commission need not address whether any of Redacted property is exempt. No evidence is presented that undeveloped reserves are exempt from taxation under federal law. Nor does any party argue that undeveloped reserves are exempt under the Utah Constitution, which in Art. XIII, Sec. 3 exempts certain specified properties from taxation in Utah with no mention of oil and gas property.[8]

UCA §59-2-201(1)(e) provides that the Commission shall assess at 100% of fair market value all mines and mining claims, except in cases where the Commission determines the mining claim is used for other than mining purposes. Historically, the Commission has assessed property owned by oil and gas companies, as well as companies that mine other minerals, under this section of the Utah Code. The Legislature has further provided in Section 59-2-201(3) that:

> [t]he method for determining the fair market value of productive mining property is the capitalized net revenue method or any other valuation method the commission believes, or the taxpayer demonstrates to the commission's satisfaction, to be reasonably determinative of the fair market value of the mining property. . . .

We note that in UCA §59-2-201(3) the Legislature has provided the Commission some latitude in approving a valuation method to determine the fair market value of productive mining property for assessment and taxation purposes. While the statute specifies that the method may be the capitalized net revenue method, it offers, in the alternative, that the Commission may choose a method that it believes, or that has been demonstrated to its satisfaction, to be reasonably determinative of the fair market value of productive mining property.

Given this latitude, the Commission adopted the amendments to Rule 10 in 1992, which incorporated a DCF valuation model to assess an oil and gas entity's taxable tangible

8 Although one of Redacted arguments is that undeveloped reserves may be considered "intangible" property not subject to property tax assessment, the Commission's ruling is not dependent on a determination of this issue.

property. The model determines fair market value for assessment and taxation purposes by considering the income stream attributable to an entity's developed reserves, but not its undeveloped reserves. Although there have been a few subsequent amendments to the rule, they have mainly refined the model adopted in 1992. No amendment has addressed the measurement of the effect attributable to undeveloped reserves for assessment purposes.

One could argue that the Commission was precluded, under the statute, from adopting a rule that would capture any value attributable to undeveloped reserves because UCA §59-2-201(3) only provides for the assessment of **productive** mining property. If this were true, Rule 10, which was amended in 1992 to ascribe value to developed reserves (those in production or for which a plan for production existed as of the lien date), would arguably over-assess oil and gas property. This is because it attributes value not only to property that is productive as of the lien date (reserves in production), but also to property not yet productive as of the lien date (reserves not in production but for which a plan of production existed as of the lien date). However, the Commission does not believe the Rule 10 valuation method over-assesses oil and gas property for this reason because it interprets the statute otherwise.

The Commission believes that the word "productive" in UCA §59-2-201(3) has broader application than just those reserves literally in production as of the lien date. Certainly, such was the case in 1992 when the Commission adopted Rule 10, which measures the effect on value for a portion of reserves that are not in production as of the lien date (i.e., those reserves not in production but for which a plan of production exists as of the lien date).

Redacted however, claims that Rule 10 fails to provide for a methodology to measure additional value attributable to proved undeveloped reserves, another portion of reserves that are not productive as of the lien date (i.e., those reserves neither in production nor for which a plan of production exists as of the lien date). A similar complaint was presented in opposition to Rule 10 when it was proposed in 1991. However, the Commission amended the rule anyway, and in so doing, chose a valuation method that it believed to be reasonably determinative of the fair market value of productive mining property, as specifically authorized by the Legislature. The fact that the Commission adopted a valuation method that excluded value specifically attributable to undeveloped reserves does not mean that it determined all or any part of such reserves to be exempt from taxation under Utah law. It merely means that the Commission considered the Rule 10 valuation model to be reasonably determinative of the fair market value of productive mining property even though the model did not quantify the effect on value of undeveloped reserves. As of the lien date, January 1, 2003, the relevant provisions of Rule 10 that were adopted in 1992 are still in effect. Those provisions were adopted with the knowledge that the DCF valuation model would measure the effect on value attributable to developed reserves, but not to undeveloped reserves.

Given the Utah law in effect as of the lien date, January 1, 2003, the Commission proceeds to address the two legal theories relating to the taxability of Redacted undeveloped reserves for the 2003 tax year.

1. Would the use of a valuation method that specifically measures the impact of Redacted undeveloped reserves for assessment and taxation purposes for the 2003 tax year result in a violation of the federal and state equal protection provisions?

The Utah Constitution in art. XIII, Sec. 2(1) provides that taxable tangible property shall be assessed and taxed at a uniform and equal rate. Due to this provision, Redacted argues that it would be unconstitutional to ascribe value to Redacted undeveloped reserves for the 2003 tax year because no other Utah centrally assessed oil and gas entity was assessed and taxed in 2003 on a value that included a measurement of the impact attributable to undeveloped reserves.

In *Rio Algom Corp. v. San Juan County*, 681 P.2d 184 (Utah 1984), the Utah Supreme Court quoted from *San Antonio School District v. Rodriguez*, 411 U.S. 1, 40 (1973), in which the United States Supreme Court provided:

> No scheme of taxation, whether the tax is imposed on property, income, or purchases of goods and services, has yet been devised which is free of all discriminatory impact. In such a complex arena in which no perfect alternatives exist, the Court does well not to impose too rigorous a standard of scrutiny lest all local fiscal schemes become subjects of criticism under the Equal Protection Clause.

Nevertheless, the Utah Supreme Court also recognized that "[w]hile absolute equality and uniformity in the assessment of property is not practicable, a requirement of reasonable uniformity and equality is essential." *See Kennecott v. Tax Comm'n*, 799 P.2d 1156 (Utah 1990), *quoting Harmer v. State Tax Comm'n*, 452 P.2d 876, 879 (Utah 1969).

When Rule 10 was adopted in 1992, the Commission understood that the DCF valuation model would measure the effect of the income stream from developed reserves to assess mining properties owned by centrally assessed oil and gas entities located in Utah, but would not measure the effect of their undeveloped reserves. This policy was adopted only after no participant in the rulemaking procedure proposed a model that included a measure of the effect of such reserves. The rule has been applied in this manner ever since, including the 2003 tax year, in which the Division did not measure the effect of any centrally assessed oil and gas entity's undeveloped reserves. Were the Commission to determine that Redacted 2003 assessed value had to reflect a quantification of the impact of its undeveloped reserves, it would be singled out as the only centrally assessed oil and gas entity assessed on this basis. Redacted contends that such an action would violate the principle of uniformity and the equal protection provisions of the state and federal constitutions, even if the measurement of the value attributable to its undeveloped reserves, in addition to developed reserves, represented the property's fair market value.

A set of circumstances with certain similarities arose in *Allegheny Pittsburgh Coal Co. v. County Com'n*, 109 S.Ct. 633 (1989), in which the United States Supreme Court determined that the assessment of a coal company in West Virginia, although based upon its recent selling price, violated the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution because it subjected the coal company to taxes not imposed on others of the same class. West Virginia's Constitution provided that the taxation of property shall be equal and uniform and in proportion to its value, provisions similar to those found in the Utah Constitution. In *Allegheny*, a West Virginia county assessor assessed fee, surface, and mineral interests owned by a coal company at a value based on their recent selling price. Her practice was to set the appraised value of properties at the declared price at which it last sold, and while some adjustments were made to properties not recently sold, these adjustments were nominal in effect. As a result, the practice resulted in gross disparities in the assessed value of generally comparable property, with the Petitioner's property being assessed 8 to 35 times higher than other comparable property.

The West Virginia County argued that it used exceedingly accurate information, the price at which the property had sold, to assess the property at its true market value. In the case before the Commission, Redacted recently purchased the oil and gas properties at issue. However, should Redacted be assessed and taxed for the 2003 tax year based on the recent selling price of its assets, such an assessment may be unconstitutional if it reflects the value of undeveloped reserves and the assessments of other centrally assessed taxpayers were not adjusted to reflect the value of their undeveloped reserves.

In *Allegheny*, the Supreme Court stated that "[a]s long as general adjustments are accurate enough over a short period of time to equalize the differences in proportion between the assessments of a class of property holders, the Equal Protection Clause is satisfied." The adjustments to other properties of the same class in *Allegheny* were minimal, however, and the Court found the assessment method under review to be unconstitutional because it led to "taxation which in fact bears unequally on persons or property of the same class." Quoting *Charleston Fed. Savings & Loan Assn. v. Alderson*, 324 U.S. 182 (1945).

In considering Redacted case, the Commission notes that numerous other centrally assessed Utah oil and gas entities were assessed in 2003 without any value being specifically ascribed to their undeveloped reserves. Regardless of what happens to Redacted the 2003 assessed values of the other Utah oil and gas entities will not be adjusted because the tax rolls for 2003 have already closed. To consider the impact on value attributable to undeveloped reserves owned by Redacted because of its recent purchase would result in it being assessed, and consequently taxed, in a manner that would bear unequally on persons or property of the same class. Adjusting Redacted 2003 assessed value due to a completely unique valuation methodology without ensuring that like taxpayers would be similarly burdened would be unconstitutional because the transitional adjustments made to the other centrally assessed Utah oil and gas entities would not be just minimal, which the Court found unconstitutional in *Allegheny*, they would be nonexistent in this instance.

The Court in *Allegheny* further explained that when viewed in isolation, the assessment of the Petitioner's property may fully comply with West Virginia law. Nevertheless, "[t]he equal protection clause . . . protects the individual from state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class." *See Allegheny, quoting Hillsborough v. Cromwell*, 326 U.S. 620,623 (1946). Similarly, whether or not Utah law provides for the assessment of undeveloped oil and gas reserves, Redacted is protected from the state selecting it out as the only centrally assessed oil and gas entity whose undeveloped reserves would be subject to taxation for the 2003 tax year.

A recent Utah Supreme Court case also appears to support this conclusion. In *Mountain Ranch Estates v. Utah State Tax Commission*, 2004 UT 86 (2004), the Court found that a taxpayer assessed at fair market value could not establish a violation of its constitutional right to a uniform and equal assessment without providing evidence of more than one comparable property with a valuation disparity.[9] However, the Court stated that "[t]he presence of multiple unfairly advantaged properties necessarily raises the suspicion of a potential inequality" and "[w]here an accurate fair market value assessment stands apart from a group of undervalued comparable properties, valuation accuracy may not be used to defend the otherwise aberrant assessment." In the matter before the Commission, neither Redacted nor any of the other multiple centrally assessed oil and gas entities have been assessed based on a valuation or appraisal method that measures the effect of their undeveloped reserves. Should Redacted assessment be increased to reflect the value attributable to such reserves, all other entities with similar reserves would be unfairly advantaged. Even were it shown that Redacted fair market value, as defined by law, should be based in part on factors attributable to its undeveloped reserves, such an assessment would stand apart from a group of undervalued comparable properties and be deemed an unconstitutional, aberrant assessment.

For these reasons, we find that, for purposes of assessing and taxing Redacted for the 2003 tax year, a valuation method that reflects the impact attributable to all or a portion of its undeveloped reserves would violate the federal and state equal protection provisions because it

9 In *Mountain Ranch Estates*, the Court addressed the evidence that must be established before a taxpayer claiming a valuation disparity is entitled to statutory relief under UCA §59-2-1006(4). Furthermore, the Court stated that the constitutional issue "turns on the same theory" as the statutory one, finding that evidence of more than one comparable property with a disparate valuation is also required to establish a violation of the constitutional equal protection provisions. We do not address the statutory remedy in the matter at issue because that remedy requires evidence not in the record, specifically evidence of percentage differences in assessments. However, such evidence is not required to address the constitutional issue.

would result in Redacted being the only centrally assessed oil and gas entity subject to such assessment and taxation. Accordingly, we find that a valuation methodology, which relies on specifically measuring any portion of the impact of undeveloped reserves, may not be used to determine Redacted fair market value for purposes of assessment and taxation for the 2003 tax year.[10]

> **2. Does Utah law in effect on January 1, 2003 forbid, in general, a valuation method that measures the impact of undeveloped reserves in establishing, for assessment and taxation purposes, the fair market value of centrally assessed oil and gas properties?**

As we have already determined that Redacted undeveloped reserves are not to be considered in 2003 because of the state and federal equal protection provisions, we do not reach this portion of the analysis. Nevertheless, the Commission takes this opportunity to make some observations about the Rule 10 DCF formula and the process by which it was derived. Earlier, we took official notice of information concerning the 1992 amendment to Rule 10, under which centrally assessed oil and gas properties have been valued for well over a decade. Without question, the process that led to the adoption of the Rule 10 amendments in 1992 was a lengthy and difficult endeavor for which there appeared to be no one solution that would satisfy all

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10 Redacted asserts that because certain proved undeveloped reserves were held to be taxable in a recent California case, *Maples v. Kern County Assessment Appeals Board* (2002) 103 Cal.App.4th 172, such reserves should also be taxable in Utah. However, in that case, California's administrative rule specifically defined and required the taxation of "proved reserves," which included both "proved developed reserves" and "proved undeveloped reserves." No equal protection issue was addressed in the California case, which determined the reserves in question to fall within definitional parameters already intended by its rule. Utah's Rule 10, which sets forth a different assessment strategy, was not intended to measure the impact of undeveloped reserves. The Commission finds the California case to have no impact on its decision in this matter.

parties. However, after much effort, the parties finally agreed to an administrative rule by which centrally assessed oil and gas companies would be assessed. The counties enumerated several concerns with the 1992 proposed amendments to Rule 10, one of these being that the DCF model specified in the rule did not provide for a value based on the measure of the impact of undeveloped reserves. Nevertheless, they withdrew their opposition to the rule and asked the Commission to adopt it for the 1992 tax year, even though the Commission had guaranteed the counties a period of least six months to obtain studies and suggest a better valuation method. Even when the counties withdrew their opposition to the rule, the Commission made clear that it would consider in the rulemaking process any future valuation method the counties might present to address their concerns. The counties have yet to submit, for consideration in the rulemaking process, another valuation method that might reasonably be determinative of the fair market value of oil and gas property, as set forth in UCA §59-2-201(3).[11]

When so many years of study and negotiation were required to generate a rule that would be used to assess the property of a specific industry, when all interested parties were afforded an opportunity and took that opportunity to participate in the rulemaking process to create that rule, and when all parties, and presumably the Legislature, has had knowledge of the rule's possible limitations or deficiencies for 12 years without acting to change such deficiencies

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11 UCA §63-46a-12 allows an interested party to petition for a change in an administrative rule. Redacted in its Opposition to Motion, urges the Division not to attempt to use the appeals process to change Rule 10, but to request a rulemaking procedure if that was its intention. Ironically, it appears that it is Redacted that is trying to effect a rule change through the appeals process. However, we do not consider Redacted Petition in this matter to be an indirect Section 63-46a-12 request for agency

through legislative or rulemaking action, the Commission would hesitate to act unilaterally and negate such a long-standing policy without a change of legislation or case law. In addition, strong arguments exist that, under UCA §63-46b-16(4)(h), a court might find reason to overturn any attempt by the Commission to reverse this long-standing course of regulation through the issuance of an order, finding such unilateral action to be contrary to either the agency's rule or to its prior practice. For these reasons, we do not believe that the hearing process is the optimal venue to request a change in policy to assess property never previously assessed. However, because we have determined that the assessment of Redacted undeveloped reserves for the 2003 tax year would be a violation of equal protection, we do not reach the issue of whether or not a policy change is needed to ensure the valuation method in Rule 10 is reflective of the fair market value of oil and gas properties.

ORDER

Based upon the foregoing, both the Division's Motion to Strike and its Motion to Dismiss are denied. However, the Division's Motion for Partial Summary Judgment is granted and the Commission finds that the assessment of undeveloped reserves owned by Redacted for the 2003 tax year would violate the federal and state equal protection provisions. Accordingly, Redacted assessment and taxation for the 2003 tax year may not be based on a valuation method that specifically quantifies the impact attributable to undeveloped reserves. All other issues concerning the assessment and taxation of Redacted property for the 2003 tax year are reserved for an evidentiary hearing to be scheduled at a later time. It is so ordered.

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action to amend Rule 10 to allow for the assessment of undeveloped reserves.

Appeal Nos. 03-0937 and 03-0963

DATED this 15th day of November 2004.

Kerry R. Chapman
Administrative Law Judge

Appeal Nos. 03-0937 and 03-0963

BY ORDER OF THE COMMISSION.

The undersigned have reviewed this motion and concur in this decision.

DATED this 15th day of November 2004.

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

STATE TAX COMMISSION SEAL STATE OF UTAH

Palmer DePaulis
Commissioner

Marc B. Johnson
Commissioner

KRC/03-0937.sjd

EXHIBIT B

November 13, 1991

Honorable R. H. Hansen, Chairman
Utah State Tax Commission
160 East 300 South
Salt Lake City, UT 84134

Re: Proposed Revision to R884-24-10P

Dear Chairman Hansen:

The Five County Oil and Gas Valuation Task Force, composed of representatives from Duchesne, Grand, San Juan, Summit and Uintah counties, their constituent school districts, and the Utah State Office of Education presents the following written comments on the October 31, 1991, proposal to modify R884-24-10P ("Rule 10P"). Rule 10P governs the valuation of underground rights in land that contains deposits of oil and gas.

Background

Section 59-2-201, Utah Code (1991) requires that the fair market value of productive mining property be determined by the capitalized net revenue method or any other valuation method the commission believes, or the taxpayer demonstrates to the commission's satisfaction, to be reasonably determinative of the fair market value of the mining property. This statutory language was enacted in 1987 to become effective January 1, 1988. Prior to that time, predecessor Section 59-5-61, Utah Code (1965) required only that owners of valuable hydrocarbon deposits file annually with the tax commission a sworn statement in detail of the property owned and the value thereof, together with such other information and in such form as the tax commission required.

Dating back to at least 1978, the Utah State Tax Commission has applied a regulation like current Rule 10P to value oil land gas properties. At that time, metalliferous mines were valued at ten times[1] their net proceeds in the previous year. In apparent recognition of the special character of oil and gas properties, Rule 10P applied a multiple of only five to hydrocarbon deposits. At the same time, for reasons that appear to relate to a "rule of thumb" then in vogue in the oil and gas industry, Rule 10P assumed that net proceeds were 80% of gross revenues. Thus the "400% Formula" that currently serves as the basis for assessment of hydrocarbon properties is calculated as 5 x 0.80 x gross revenues for the previous year.[2]

The 400% Formula has several distinct advantages for taxpayers. First, because the formula always looks at past

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[1] In actuality, since all property was assessed at twenty percent of its fair market value before January 1, 1986, the actual multiple prior to that date was two times net proceeds. For ease of reference, this comment assumes that all properties have always been valued at full value.

[2] In recognition of the greater cost of producing from particular areas and in particular ways, Rule 10P provides for a 20% reduction for oil properties in the Greater Altamont/Bluebell field, and a 10% reduction for properties in secondary recovery. Federal, state and Indian royalties and federal windfall profits taxes were also permitted as deductions.

production, the taxpayers enjoy a one year delay in the payment of property taxes that continues throughout the life of the property. Second, the tax is predictable and can be included in economic analyses as a percentage of production. Third, though somewhat arbitrary, the 400% Formula does not make any attempt to predict future cash flows. During the period from 1979 to 1985, when oil companies were projecting oil prices in excess of $100 per barrel, and takeovers in the oil industry were rampant, the 400% Formula generated extremely conservative property values. Finally, the 400% Formula made no attempt to reach values of undeveloped reserves, values which can frequently be substantial

The predictability of the 400% Formula also was a positive factor for counties and school districts that must plan for regular expenditures regardless of the price of oil. School districts, in particular, relied on the 400% Formula in incurring bonded indebtedness to construct and improve schools in oil boom areas. For this predictability, counties and school districts were willing to delay property tax receipts for a year and give up the potential tax bonanza that discounted cash flow might then have generated.

The sharp drop in oil prices in early 1986 sent a shock wave through the oil industry. Oil companies immediately began casting about for ways to reduce their costs. Exploration expenditures were the first to be cut, but the companies eventually got around to looking at property tax payments.

Beginning in 1989, oil companies began to challenge their property valuations under the 400% Formula. They were aided in this effort by the 1989 amendment to Rule 10P that stated:

> The reasonable taxable value of productive underground oil and gas rights shall be determined by the [400% Formula] <u>or such other valuation method that the Tax Commission believes to be reasonably determinative of the property's fair market value</u>.

The five oil producing counties in Utah, and their school districts, continued to rely on the 400% Formula in their budgeting and bonding decisions, either ignorant of the change in Rule 10P, or assured by officials in the Tax Commission office that the change in Rule 10P was designed to address the most obvious injustices in application of the 400% Formula, but would not affect the great bulk of valuation decisions.

In the Fall, 1991, the five counties and their school districts were finally advised that a major overhaul of Rule 10P had been under consideration for some time, that the oil industry had given its blessing to proposed language, and that the Tax Commission would shortly begin official consideration of the proposed change, hopefully in time to go into effect by January 1, 1992. Representatives of the five counties were told to expect reductions of 40% in the Uintah Basin, with lesser reductions in Southeastern Utah.

It is worth noting that oil company protests about application of the 400% Formula are largely confined to Duchesne, San Juan and Uintah counties. For whatever reason, Grand and Summit counties have been relatively free of 400% Formula protests. It is also noteworthy that, in 1990, the five counties supported the oil industry's successful bid for a reduction in Utah's severance tax. That support was based upon the assumption that the 400% Formula would remain in effect for those taxpayers.

Comments

I. THE 400% FORMULA REASONABLY APPROXIMATES MARKET VALUE IN THE MAJORITY OF CASES AND HAS ADVANTAGES FOR THE TAXPAYER AND THE TAX COLLECTOR.

I.A. The 400% Formula is Fair and Predictable.

There is something inherently unfair about permitting taxpayers to elect, from year to year, their preferred assessment method. Any taxpayer given such an option, in his own self interest, will always select that method of valuation which results in the lowest tax. That is clearly what has occurred here. From 1979 to 1985, taxpayers were drilling new wells, oil prices were rising and predicted to rise further, enhanced recovery methods were implemented, and production increased dramatically. Projected cash flow in those heady years would have been enormous. No oil company came forward then and advocated a change to discounted cash flow methods.

Now that production is declining, exploration has slowed, and prices have gone down (and then back up a bit), the taxpayers advocate discounted cash flow. It is proper to view such petitions with a jaundiced eye. The rules under which the game has been played thus far are entitled to deference when determining how to play in the future.

Discounted cash flow, based as it is on projections, will always tend to exaggerate the latest trend. With discounted cash flow, the kinds of fluctuations that taxpayers and government have learned to live with in the past, at substantial cost, will be exacerbated and even more difficult to handle. Predictability in tax rates benefits the taxpayer and government.

I.B. The 400% Formula Does Not Appraise All Values.

An advantage for taxpayers, though a disadvantage to government, is that the 400% Formula taxes only producing properties and then only on the basis of actual production. The producer may be sitting on the largest oil field in the lower 48, and know it, but as long as he doesn't produce it, no tax is due. In fact, no tax is due even when it is produced, but not until November 30th of the following year.

The producer who willingly sits on a find is rare. However, it frequently happens that two pay zones are discovered, but the second cannot be produced until the first is largely exhausted. Sometimes additional reserves are known but developed by drilling additional wells only when the time is right. Secondary and tertiary recovery must also await the proper moment. The 400% Formula does not attempt to tax the known and real value of underground deposits not yet in production.[3]

Another real value of oil and gas properties is the value of an undrilled lease. Every year oil companies bid millions of dollars for the right to gamble on the existence of oil under federal, state and private lands. The sale prices of federal and state leases are reported publicly. The competition is frequently fierce, and values are obviously affected by distance from known fields or recent discoveries. None of those values have been subjected to the property tax, notwithstanding the abundance of comparable and actual sales data showing real values for those leases. Nothing in the Utah Constitution or Utah law prohibits taxing these values.

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[3]The importance of undeveloped reserves becomes apparent when one considers the history of the Aneth field, which generates almost half of San Juan county's property value. Application of the discounted cash flow methodology to the Aneth field in 1954, the year of its discovery, would undoubtedly have predicted field extinction by 1980. Quite the contrary occurred, as oil companies doubled the number of wells, then doubled them again in some areas, and in others implemented tertiary recovery methods. These actions, combined with application of new technologies, has preserved the Aneth field for at least another 25 years.

The task force recognizes that the failure of the 400% Formula to reach these values does not argue for its accuracy. It does, however, argue against the industry claims of excessive taxation.

I.C. The 400% Formula Reasonably Approximates Value.

The task force has requested that members of the oil and gas industry pressing for modification of Rule 10P back up their claims with randomly selected actual sales data showing that the method of discounted cash flow they have blessed accurately estimates fair market value. No positive response to that request has yet arrived.

The task force has received information from Pete Huddleston, a consultant hired by the industry, that, over the course of a well's life, expenses usually equal 35% of revenues. No clarification of whether the 35% includes royalty expenses has been received. Assuming that it does, and assuming a royalty of 15%,[4] the assumption implicit in the 400% formula that expenses (exclusive of royalties) are 20% of production appears to be a valid assumption.

The other assumption implicit in the 400% Formula is

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[4]Royalties on oil and gas leases typically run from 12.5% to 20%.

that value is five times the earnings of the last year. The accuracy of that assumption depends on the rate at which production declines. At a time when the federal discount rate is at an 18 year low, when stocks are selling at record multiples of earnings, a multiple of five seems reasonable indeed.

I.D. <u>The 400% Formula is Based on Concrete Data, Free of Speculation</u>.

The method which Utah law presumes and prefers for oil and gas properties is "capitalization of net revenues." The task force believes that the 400% Formula, based as it is upon <u>actual</u> revenues, is preferred under the statute to any method that involves projections of net revenues.

Projections of net revenues, discounted and summed, are not revenues at all, but nothing more than predictions. The task force believes that the statutory language authorizes only use of actual net revenues, not projections. Otherwise, the statute would say "capitalization of future projected net revenues." Accordingly, the method preferred by the statute must involve actual revenues. The 400% Formula estimates actual net revenues and applies a capitalization multiplier of five.

If the Tax Commission considers itself obligated to discard the assumption that expenses are 20% of gross revenues, the task force believes it should consider as the legislative preference, direct capitalization of actual net revenues. Under this method, the appraiser would apply a multiplier to the actual net revenues of each property. If the Tax Commission determines that "capitalization of net revenues" does authorize discounting and summing projections of future net revenues, the task force believes that it cannot stop these in its projections. As discussed in the following section, once projection of revenues is accepted as a valid valuation method, any revenue that can be projected must be included. No projection can be discarded simply because it reflects only probabilities.

II. THE DISCOUNTED CASH FLOW METHOD PROPOSED IN RULE 10P UNDERVALUES UNDERGROUND OIL AND GAS DEPOSITS

The task force does not reject in principle the idea of using discounted cash flow to value underground oil and gas deposits. As stated in Section I of these comments, the task force believes the 400% Formula is not nearly so arbitrary and excessive as the oil industry claims. However, the task force believes that an appropriate discounted cash flow method for valuing underground oil and gas deposits could be developed.

Discounted cash flow, unlike the 400% Formula, is not a unitary concept. One cannot say with any precision what value discounted cash flow will yield without knowing precisely what assumptions will be used in the calculation. The task force has received scanty information about how the proposed discounted cash flow method will affect assessed values. The fiscal note attached to the Notice of Proposed Rule/Change states:

> An analysis based on the best data we have available indicates that under the best case scenario, which assumes stable oil prices, the values for oil and gas properties would remain virtually the same as last year.

If this statement is true, what the Property Tax Division has told the task force is not true. If this statement is true, one wonders why the oil industry is pressing for discounted cash flow. The task force cannot adequately consider the proposed change to Rule 10P without better information from the Property Tax Division, or the tax commission, about the actual effect of the proposed change on assessed values in the five counties.

Having noted the difficulty of responding to the proposal in its present ambiguous state, the task force presents the following criticisms of the proposal as presently understood.

II.A. <u>The Proposed Rule 10P Unrealistically Assumes Constant Oil Prices</u>.

There is no question that the most difficult problem in projecting future revenues from oil wells is to predict future oil prices. As the industry's expert told the task force, "I used to try to predict the trend of oil prices. Now I accept collect calls from illegal aliens."

The task force believes that the unpredictability of oil prices is the best argument for avoiding discounted cash flow. If, however, one undertakes to tread in this dangerous area, one ought at least to adopt the forecasts of the oil industry itself. The newspapers are full of oil company predictions of future oil price shocks. At the very least, the tax commission should use the survey forecasts of the Society of Petroleum Evaluation Engineer, which currently predicts oil price escalation of 4.5 to 5.5% annually. Those figures are readily available and the best evidence of industry expectation. The task force understands that those figures are used in oil industry economic analyses.

II.B. <u>The Proposed Rule 10P Does Not Adequately Fix a Discount Rate</u>.

The task force is unable to predict with any accuracy what discount rate will be used in the proposed Rule 10P. The task force recognizes that the discount rate must change as market conditions change, and that the greater risk associated with oil and gas assets justifies a higher rate.

The lending industry currently indexes adjustable rate home mortgages to the weekly average of treasury, securities adjusted to a constant maturity of one year. The common index is 2.5% above this rate. Allowing that oil and gas properties are more risky than home mortgages,[5] the task force would accept an index 4.0% above the weekly treasury securities rate.

II.C. The Proposed Rule 10P Ignores Undeveloped Values.

Perhaps the most comprehensive criticism of proposed Rule 10P is that, having undertaken to project cash flows from oil and gas properties, it then ignores important components of those flows. The resultant undervaluation could be compared to assessing a subdivision based only upon the homes actually constructed. The vacant lots, not yet developed, have obvious value that is not ignored by county assessors. The tax commission should do no less in performing its statutory duties.

Here are a few examples of escaped value:

1. Undrilled leases. Until recently, the Bureau of Land Management routinely performed a discounted cash flow analysis on properties proposed for oil and gas leases. The analysis incorporated the probabilities of different outcomes, projected cash flows from discoveries, and assigned values to the leases. Bids below that appraised price were not accepted.

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[5] Depending on the location of the home.

The BLM has discontinued this practice for federal leases, choosing to rely on the competitive bidding process to establish those values. However, for Indian leases, the BLM still uses discounted cash flow to appraised lease values.

Whether the tax commission chooses to rely on competitively bid prices to establish lease values, or the BLM appraisal method, it cannot ignore the very real value of undrilled leases. Once the tax commission undertakes to predict the future, it cannot ignore the value of future production from undrilled leases.

2. Production from Future Drilling. When a company successfully encounters oil or gas in paying quantities, it almost always plans a second well, and so on. The success rate of such wells, known as development wells, is extremely high. No rational oil company would sell such a property after the first well comes in without considering the production likely from subsequent wells.

A discounted cash flow method based upon projected production from the first well alone ignores very real and very predictable values. If the tax commission is to use discounted cash flow, it must include cash flow from predictable future drilling.[6]

This is not an insubstantial consideration. In the Aneth field, for example, wells were originally drilled on 80 acre spacing. Since that time, additional wells have been drilled throughout the field on 40 acre spacing. In the Aneth Unit, some 20 acre wells have been drilled. The reasons for this additional drilling are complex, but the values uncovered were real and predictable long before the wells were actually drilled.

3. Production from Enhanced Recovery. All of the possibilities for enhanced recovery cannot be described here. It is enough to point out that application of enhanced recovery methods can be predicted with reasonable certainty. No rational oil company would ignore those possibilities when selling a property. The tax commission should not do so either.

If the Property Tax Division is to capture all of these "escaped values", it must have more ammunition than proposed Rule 10P provides. The obvious truth about these values is that the oil companies themselves have the best information about these values. If the Property Tax Division cannot get that information, that deficiency argues against adopting proposed Rule 10P.

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[6] Less, of course, the cost of drilling the well.

II.D. Proposed Rule 10P Makes No Provision for a Transition.

All of the oil producers have been paying taxes based upon the 400% Formula for more than a decade. As discussed earlier, the 400% Formula has the significant benefit of delaying all tax payments one year. In the change from the 400% Formula to proposed Rule 10P, which is a change from looking backward to looking forward, the present escapes taxation.

One example would suffice. Suppose that Oil Company A began production from the Bonanza Well on January 1, 1991. No 1991 taxes will be assessed on that well because there was no 1990 production and the 400% Formula governs 1991. Assume that proposed Rule 10P goes into effect on January 1, 1992, and that production from the Bonanza Well rapidly declines and ends on December 31, 1991. The production from that well will never suffer a property tax.

This is an extreme example, but the principle lit illustrates is true for every well. Without a transition rule, one year of production from every well will totally escape taxation. If proposed Rule 10P, or indeed any discounted cash flow method, is adopted, it must include a transition rule to make sure that value is taxed.

II.E. Proposed Rule 10P Does Not Value Production Before

The Lien Date.

Related to the transitional problem described in Section II.D. above is the problem of the interaction of any discounted cash flow method with the lien date. Properties are valued as of January 1, of each year. Properties or values that do not come into existence until January 2 escape taxation. For most properties, that is not a problem, since the value of the property tends to remain constant. There is no significant depreciation in value from the date the property comes into existence until the following January 1.

For oil and gas properties, however, individual wells usually have their highest value immediately after successful completion. Under proposed Rule 10P, production from that date until the following January 1 will never figure into the discounted cash flow value. For many wells, that loss constitutes a substantial portion of the lifetime value of the well.

The task force sees no constitutional or statutory impediment to including in the first years value. The cash flow that preceded the January 1 lien date. If there is such an impediment, adoption of proposed Rule 10P should be delayed until the impediment is removed.

III. DISCOUNTED CASH FLOW SHOULD BE USED ONLY IF TASK FORCE

CONCERNS ARE APPRESSED

The task force has no philosophical objection to using discounted cash flow to value oil and gas properties. As discussed above, the task force believes that the 400% Formula, in the long run and in consideration of all relevant factors, is the preferred method. The task force has also described the deficiencies of Proposed Rule 10P. However, if the Tax Commission determines that discounted cash flow must be utilized, the task force would find acceptable a rule that includes the following elements:

A. Escalation of oil prices in accordance with Society of Petroleum Evaluation Engineer survey forecasts.

B. Valuation of undrilled leases and undeveloped reserves.

C. Use of a discount rate of 4.0% above the treasury securities rate.

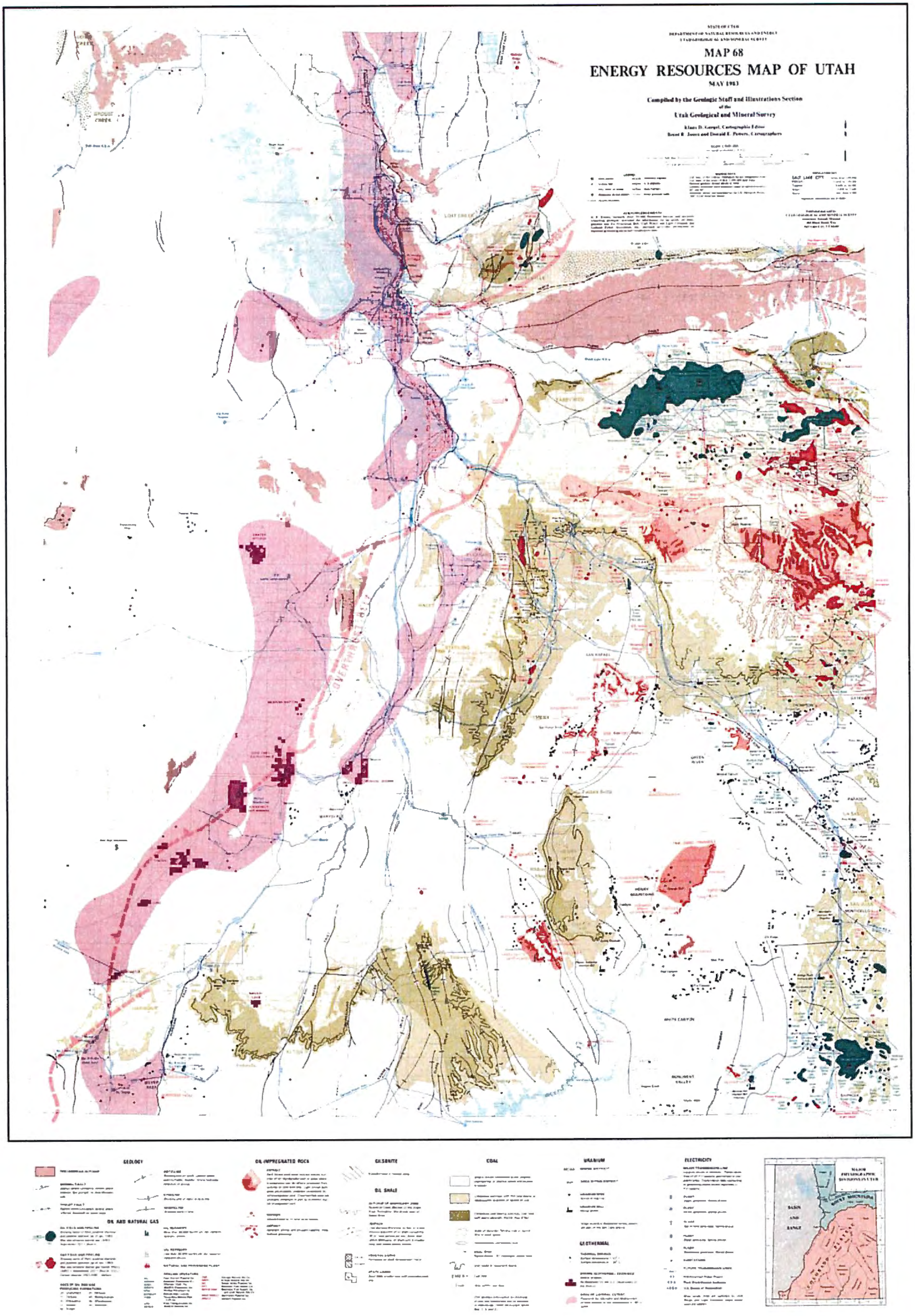
D. A transition rule that requires inclusion of the income of the priori year in the first year's value.

E. Inclusion of pre January 1 net revenues in the first year's value.

Assuming all of these provisions were included in proposed Rule 10P, the task force would find the use of discounted cash flow acceptable, subject of course to protests about its actual application. The task force reiterates, however, its position that the 400% Formula is preferable because of its ease of administration and because it is more predictable and fair. The task force would propose that the Tax Commission offer each taxpayer the option of electing either method. Once elected for a particular well, the election could be changed only with the approval of the affected county.

RDLTR.RHH

EXHIBIT C



MAP 68
ENERGY RESOURCES MAP OF UTAH
MAY 1983
Compiled by the Geologic Staff and Illustrations Section
of the
Utah Geological and Mineral Survey
GEOLOGY
OIL-IMPREGNATED ROCK
GILSONITE
OIL SHALE
COAL
URANIUM
GEOTHERMAL
ELECTRICITY
OIL AND NATURAL GAS

EXHIBIT D

IN THE EIGHTH JUDICIAL DISTRICT COURT
IN AND FOR UINTAH COUNTY, STATE OF UTAH

James Harvey Jordan, Trustee of the James H. Jordan Revocable Trust dated June 1, 2007, Martha Jordan Boright, Mary Edna Jordan, Michael C. Kelley, and Jary Anne Kelley, Trustee of the Kelley Joint Trust dated January 7, 2013, Gary E. Kelley, Norma Stroud Dickey, Mara Beth Harner, Jan Rhodes as Trustee of the Revocable Rhodes Family Living Trust dated April 19, 2005, Wendy Sue Pack, Craig McSorley, Deborah J. Bowers, Laura Ward, Mark McSorely, Plaintiffs/Counterclaim Defendants, vs. Eddie R. Jensen and Ly-Thi Jensen, Defendants/Counterclaim Plaintiffs.	RULING AND ORDER Case No. 130800084 Judge SAMUEL P. CHIARA
Eddie R. Jensen and Ly-Thi Jensen, Third-Party Plaintiffs, vs. Axia Energy, LLC, Stonegate Resources, LCC, Wasatch Oil & Gas, LLC, Third-Party Defendants.	

This matter is before the Court on the Plaintiffs/Counterclaim Defendants' Motion for

Summary Judgment; the Defendants/Counterclaim Plaintiffs/Third-Party Plaintiffs' Motion for Summary Judgment; and the Third-Party Defendants' Motion for Summary Judgment.

The Court heard oral argument on the Motions on September 24, 2014. The Court has thoroughly reviewed the arguments of counsel, the Motions, the supplemental pleadings, and the relevant case law and statutes. This Ruling and Order will resolve all three of the pending Motions for Summary Judgment.

Initially, the Court recognizes the passage of time in issuing this Ruling and Order. Unfortunately, the necessary recusal of Judge Peterson, followed much later by the recusal of Judge McClellan, as well as the difficulty of the issues, resulted in a longer delay than is typical. The Court thanks the parties and counsel for their patience. The Court would also like to recognize the exceptional quality of each party's arguments and written briefs. The level of professionalism all sides displayed was outstanding. The quality of the legal work is very high. The arguments are well reasoned and thorough, which made the decision difficult, but also left the Court confident the parties have accurately presented the full scope of the law dealing with these issues.

<u>Undisputed Material Facts</u>

1. The property that is the subject of this case consists of approximately 40 acres in Randlett, Utah, legally described as the Northeast quarter of the Northeast quarter of Section 32, Township 7 South, Range 20 East, Salt Lake Meridian.
2. On October 25, 1954, Olivia Jordan, Marie Robertson, and Caroline Kelley (the "Jordans") acquired the property.
3. The Jordans sold the property to Jonathan Anthony Andrews, reserving the oil, gas, and

mineral rights. The deed is dated February 3, 1995, and recorded March 15, 1995, at Book 592, Page 95, in the Uintah County Recorder's Office.

4. The real property tax notice for the 1995 taxes on the property was mailed by Uintah County to Olivia Jordan c/o Jonathan Anthony Andrews, P.O. Box 5451, Gainsville, Fl. 32602.

5. The 1995 taxes were not timely paid.

6. The 1996 tax notice was sent to Jonathan Anthony Andrews, at P.O. Box 851981, Richardson, Texas. Those taxes in the amount of $32.42 were paid on November 21, 1996.

7. The 1997 tax notice was sent to Jonathan Anthony Andrews at the Richardson, Texas address. The 1997 taxes in the amount of $35.92 were paid on December 10, 1997.

8. On November 17, 1997, $33.05 was paid on the 1995 taxes. After payment on penalties and interest, there was a balance owing of $8.94.

9. The 1998 and 1999 tax notices were sent to Johnathan Anthony Andrews at the Richardson, Texas P.O. Box. The taxes for 1998 and 1999 were not paid.

10. For failing to pay the real property taxes assessed for the 1995, 1998, and 1999 tax years, resulting in a past due amount of $167.19, Uintah County seized and sold the property on May 25, 2000.

11. The record of delinquent taxes prepared by the treasurer and recorded states that the date of the tax lien is January 16, 1996[1], and date of delinquency is January 16, 1996.

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[1]All parties agree this date is incorrect, and likely due to a typographical error. The taxes for the 1996 year were paid. The record should have indicated a tax lien date and delinquency date of January 1, 1995, as there remained a balance due on the 1995 taxes.

12. The assessment and levy for the 1995 tax year did not occur until on or after May 12, 1995.

13. No notice was ever given to the Jordans of the assessment of 1995, the failure to pay the taxes, or the tax sale.

14. On May 25, 2000, Uintah County executed a tax deed concerning the property. The grantee was Quality Remediation Services ("QRS"), who paid the County $6,000.00.

15. On December 13, 2000, QRS executed a warranty deed concerning the property. The Jensens were the grantees, and paid $5,500.00 to QRS.

16. In a January 2001 Real Property Transfer Survey Standard Land Questionnaire the Jensens indicated they paid fair market value for the property, and that the sale did not include the mineral rights.

17. Prior to March 2013, the Jensens never asserted a claim to own the mineral rights in the property.

18. Since 1995, the Jordans have periodically leased the oil, gas, and mineral rights.

19. In May 2011, Stonegate entered into oil and gas leases with the successors in interest to the Jordans. In August of 2011, Stonegate assigned the working interest in these leases to Axia, reserving for itself and Wasatch a royalty interest.

20. In November 2011, the Jensens entered into a Surface Use Agreement and Grant of Easements, allowing Axia to conduct exploration and drilling operations on the property.

21. Over time, Axia has paid the Jensens $21,182 under the Surface Use Agreement.

22. Axia paid all the taxes associated with the mineral rights in 2012 and 2013, totaling $84,878.32.

Analysis

Summary judgment is appropriate only when no genuine issue of material fact exists and the moving party is entitled to judgment as a matter of law. *Ehlers & Ehlers Architects v. Carbon County*, 805 P.2d 789, 791 (Utah App. 1991); Utah R. Civ. P. 56(c). The facts and evidence are viewed in a light most favorable to the nonmoving party. *America Mut. Ins. Co. v. Schettler*, 768 P.2d 950, 957 (Utah App. 1989).

The Motions concern competing claims to title of the oil, gas, and mineral estate. There is no dispute of material fact. Therefore, the issue can be determined as a matter of law.

I. Whether Uintah County's 1995 general assessment included taxing the mineral interest?

The first issue is whether the Jordans' oil, gas, and mineral rights were severed from the surface estate and not assessed or levied on by Uintah County in 1995.

The Jordans[2] argue that the mineral estate was reserved at the time of conveyance of the surface rights to Mr. Andrews on February 3, 1995. The Uintah County Assessor assessed the property on May 22, 1995. Consequently, the Jordans argue that the County Assessor did not assess the mineral rights because the mineral estate had been severed by that time. Because the County Assessor did not assess the mineral rights, the Jordans argue there was no levy.

The Jensens argue that pursuant to Utah Code Ann. § 59-2-103 the 1995 tax assessment occurred on January 1, 1995, before the February 3, 1995, severance. The Jensens argue that the

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[2] The Jordans and Axia argue for the same result, and largely offer the same arguments and cite to the same case law in their separate Motions and separate replies. For clarity and brevity, the Court will refer to the Jordans when discussing both the Jordans' and Axia's arguments and positions.

lien for the 1995 unpaid taxes attached as of January 1, 1995. As a consequence, the Jensens argue that the mineral rights were levied and properly passed by tax deed at the 2000 tax sale.

"Tax sale proceedings are predicated and founded upon failure to pay a tax assessed against the property, and, therefore, no validity can attach to any sale except of the property assessed and delinquent for failure to pay the tax levied on the assessment as made." *Tintic Undine Mining Co. v. Ercanbrack*, 74 P.2d 1184, 1189 (Utah 1938). "If property rights which are not included in an assessment are sold or extinguishable by a tax sale, there would be a taking of property without due process of law." *Hayes v. Gibbs*, 169 P.2d 781, 786 (Utah 1946). If Uintah County did not assess the mineral estate, the mineral estate was not subject to the tax lien and could not pass at a tax sale. Therefore, the date of assessment, and whether Uintah County had the power to assess the mineral estate, are critical.

Utah Code Ann. § 59-2-103(a) states: "All tangible taxable property . . . shall be assessed and taxed at a uniform rate on the basis of its fair market value, as valued on January 1, unless otherwise provided by law." Also, "[a] tax upon real property is a lien against the property assessed . . . [and] shall attach on January 1 of each year." Utah Code Ann. § 59-2-1325.

Notwithstanding, the issue of when the date of assessment and levy occurs has been authoritatively decided in Utah. In *Huntington City v. Peterson*, 518 P.2d 1246 (Utah 1974), Huntington City bought a parcel of land on April 7, 1959. The Emery County assessor assessed the parcel of land, and the levy for tax was made in August 1959. No notice of the tax assessment was given to Huntington City. The party assessed the 1959 taxes did not pay the taxes and the property was sold at a tax sale. The Utah Supreme Court quieted title to Huntington City, holding that the assessment occurred after Huntington City acquired the property and that no tax lien attached as a consequence.

In *Gillmor v. Dale*, 75 P.932 (Utah 1904), the Utah Supreme Court held that a property tax "does not become a lien on real estate until the rate thereof is fixed, and the tax levied . . ." because "[t]he city council was not authorized . . . to levy a tax, except on property within its corporate limits, and any levy upon property not within such limits is without authority and void." *Id.* at 934.

More recently, the Utah Supreme Court in the case of *West Valley City Corp. v. Salt Lake City*, 852 P.2d 1000, 1003 (Utah 1993), found:

> The date of assessment and levy, not the statutory lien date of January 1st, is the relevant date for determining whether property is within the reach of a taxing entity's power for the purpose of assessing, levying and collecting taxes on the property.

See also H.C. Massey v. Griffiths, 153 P.3d 312, ¶10 (Utah 2007)("Assessment is the basis of the tax title and only that interest which was properly assessed can be sold.")

The Jensens contend that Utah Code Ann. §§ 59-2-1325 and 59-2-103 dictate the lien date as January 1, of the year the property was assessed. The Jensens also attempt to distinguish the above line of cases by arguing that those cases merely apply to property transferred to a tax exempt entity. The Jensens argue the reason for treating a tax exempt entity differently is a tax exempt entity would have no reason to believe that they would be taxed. Therefore, selling a tax exempt entity's property for failure to pay taxes would be improper.

The Jensens' argument that a tax lien attaches on January 1, regardless of the date of assessment and levy, is not without support. The dissenting opinion in *Huntington*, 518 P.2d at 1249-50 (Henriod, J., dissenting), also insisted that a tax lien attaches on January 1 pursuant to statute. While the dissenting opinion is well reasoned, the majority rejected it. This Court is required to follow binding precedent, which is the majority opinion.

Further, if the above line of cases only apply to tax exempt entities, that qualification was not stated explicitly in the holdings, and the reasoning to treat tax exempt entities differently in these scenarios was not explained. If the reason is, as the Jensens suggest, that tax exempt entities would have no reason to suspect tax liability, the same reasoning would apply to the facts here. The Jordans also had no reason to suspect a tax liability to the County because: (1) their mineral interest was severed prior to taxation; (2) the mineral interest was non-productive; (3) counties are not empowered to tax a severed mineral interest under the Constitution and the Act; (4) Uintah County did not believe that they assessed these mineral interests in 1995; (5) the Jordans had never had their mineral estate assessed separately prior to 1995;and (6) the Uintah County Record of Delinquent Taxes showed the wrong lien date for the property. Based on these factors, the Jordans would have had no reason to believe that their mineral interest was taxed by Uintah County for the 1995 year.

Because the property was not assessed by the Uintah County assessor until after the February 3, 1995, severance date, the mineral estate was not assessed by the County. Uintah County only assessed the surface rights. The tax lien did not attach to the mineral rights. Consequently, authority and jurisdiction to sell the mineral rights were not acquired by the County, and the mineral interests were not sold at the May 2000 tax sale.

II. Whether Uintah County had the authority to assess the severed mineral interest?

The Jordans argue Uintah County does not have the authority to separately assess, levy, and seize mineral rights. The Jordans point to Utah Code Ann. §§ 59-2-201 and 59-5-102, et seq., which directs that counties tax the surface interest, and the Utah State Tax Commission taxes the mineral interest. The Jordans also cite to case law which hold the same. *See Telonis v. Staley*, 144 P.2d 513, 515 (Utah 1943)("Where there is separate ownership of the respective rights [referring to severed surface and mineral rights], separate levy and separate sale would necessarily follow. . . ."); *Kanawha & Hocking Coal & Coke Co. v. Carbon County*, 535 P.2d 1139, 1140 (Utah 1975)(holding Utah State Tax Commission taxes mineral rights and counties tax surface rights).

The Jensens argue Uintah County was required to tax the mineral interests as part of the general assessment. The Jensens argue that "all tangible property in the State that is not exempt . . . shall be" assessed and taxed. Utah Constitution, Article XIII, Section 2. Pursuant to Utah Code Ann. § 59-2-301, counties are required to assess all property not assessed by the Utah State Tax Commission. The Jensens argue the Commission is obligated to assess only valuable mineral deposits. The Jensens argue that the mineral estate was not valuable until 2012 when the mine started producing. Therefore, the Jensens argue Uintah County was required to assess the mineral estate in 1995 when it was not valuable, or at least, had not had a value applied to it.

Admittedly, this is a difficult issue. On one hand, if it is true that the Commission is only required to tax producing or valuable mineral interests, and counties are only authorized to tax surface rights, then there is seemingly a gap left that allows unproductive mineral interests to go untaxed. Although those unproductive mineral interests are not producing, in many instances they perhaps have some undetermined value. On the other hand, if counties are required to tax non-producing mineral interests, the practical problem of determining the value of an unproductive mineral interest arises. Additionally, Uintah County does not attempt to determine a value or apply a tax rate to severed mineral interests. Neither does Uintah County send separate tax bills, notices, or notices of sales to owners of severed mineral interests. Following Jensen's reasoning, severed unproductive mineral interests have unknowingly passed at numerous tax sales. Because Uintah County does not notify owners of severed mineral interests of assessments or tax sales, it is likely that many owners of severed mineral interests find themselves in an identical position to the Jordans. Finally, where surface and mineral interests have been severed, such as is likely the case with hundreds or even thousands of parcels in Uintah County, the county's general assessment results in only one tax bill even though there are at least two owners. That tax bill is uniformly assessed to and paid by the surface owner. Would mineral interest owners be liable to pay some portion of the tax where the mineral interest is nonproductive and not otherwise taxed? How would the property owners divide the bill? What would happen if one party paid the full amount of the bill?

The Court determines that undeveloped or undiscovered minerals underlying a piece of property are akin to an intangible asset. As an intangible asset, the undiscovered minerals fall outside the scope of Article XIII, Section 2, of the Utah Constitution, and are not subject to taxation. It follows that counties are not responsible for determining the value of undeveloped or undiscovered minerals and are not authorized or required to tax valueless property. The Jensens provide no support for their argument that counties are responsible for taxing valueless property, and the Court is not aware of any. Valueless property cannot be taxed. Applying a tax rate to property that has either no market value or an undetermined market value is pointless because the resulting tax obligation would be zero. Valuable mineral interests whose fair market value can be determined are required by statute and the Utah Constitution to be assessed by the Utah State

Tax Commission. Therefore, Uintah County did not have the authority to assess the severed mineral estate in 1995, as the mineral estate at that time was not producing, the minerals were undiscovered, and the value of the mineral estate was unknown.

III. Whether the statute of limitations bars any challenge to the May 2000 tax deed, despite no notice given to the Jordans?

If the mineral estate was properly assessed by Uintah County, and a tax lien attached, the next question is whether the Jordans' constitutional challenge based on lack of notice is barred by the statute of limitations for tax deeds.

The Jensens argue that any challenge to their purchase of the mineral estate at the May 2000 tax sale is barred by the four-year statute of limitations. Utah Code Ann. § 78B-2-206 bars any challenges to tax title after four years from the date of the sale. Section 206 states:

> an action or defense to recover, take possession of, quiet title to, or determine the ownership of real property may not be commenced against the holder of a tax title after the expiration of four years from the date of the sale, conveyance, or transfer of the tax title to any county, or directly to any other purchaser at any public or private sale. This section may not bar any action or defense by the owner of the legal title to the property which he or his predecessor actually occupied or possessed within four years from the commencement of an action or defense. . . .

The Jensens have held the May 2000 tax title beyond the four-year period set forth in Section 206. There is no argument that the Jordans did not actually possess the mineral estate at any time during the four-year time period between May 2000, and May 2004.[3]

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[3]The Court notes here the inequality the statute would create for owners of legal title to unproductive mineral estates, as they would never be able to show actual possession of an unproductive mineral estate. While it's not necessary to the outcome here, the Court finds that the Jordans exercised as much actual possession or control of the mineral estate as possible, by periodically leasing the minerals over the many years following the tax sale.

The parties have offered extensive case law on this issue from a variety of jurisdictions. The Court has reviewed the cases cited in the Motions and supplemental pleadings and found them useful for gaining a general understanding of the law on this issue. Reliance on only two of the cases is necessary and sufficient for this decision. In *Jones v. Flowers*, 547 U.S. 220 (2006), the U.S. Supreme Court found that selling a person's property at a tax sale without notice was a violation of the person's Fourteenth Amendment due process rights. The Court determined that notice of the tax sale must be reasonably calculated to reach the intended person to be deemed constitutionally sufficient. *Id.* at 226; *see also Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950). The Utah Supreme Court has addressed the issue of application of the tax title statute of limitations where the tax sale included a procedural error. *Frederiksen v. LaFleur*, 632 P.2d 827 (Utah 1981). In *Frederiksen*, the Court upheld the application of the statute of limitations barring a challenge based on a procedural defect in the tax sale (the county auditor's appointment was not made in writing, and had failed to take an oath of office, as required by statute). The Court reasoned that the purpose of the statute of limitations was to provide certainness and finality to tax sales, even if the sale was invalid because of procedural defects in the execution. Importantly for our purposes, however, is footnote 14 of the *Frederiksen* opinion, in which Justice Oaks stated in dicta, "We expressly reserve opinion on whether the special statute of limitations could protect a tax title acquired by means repugnant to fundamental fairness or whether such an application of the statute would exceed the limits of statutory intent or constitutional permissibility." *Id.* at 831, fn. 14.

Here, the Jordans were not given notice of the 1995 assessment or any assessment thereafter. The Jordans were not listed on the assessment roll. Mr. Andrews was the only one given notice of the taxes levied after the severance. The general assessments made on the Jordans' property prior to the 1995 severance never explicitly included an assessment for the mineral estate. Neither the Jordans, nor their predecessors, were ever given notice of the May 2000 tax sale. Uintah County had the addresses for the Jordans and their attorney. The County had previously sent tax notices for years prior to 1995 to Olivia Jordan.

The Court finds that this is one particular instance that Justice Oaks alluded to where the special statute of limitations does not apply. One of the most critical and fundamental due process rights is the right to notice, particularly when notice pertains to a government seizure of property. A statute of limitations that eliminates a person's right to challenge a tax sale, even when notice was not given, runs afoul of Constitutional protections. The facts here are not similar to those in *Fredriksen*, where the error in the tax sale involved a minor procedural issue. The error here was substantive and significant. Consequently the tax deed was not merely voidable and subject to the statute of limitations, as the Jensens suggest. The tax deed is void because the lack of notice to the Jordans is a jurisdictional defect of the sale. Without jurisdiction, the statute of limitations did not start, let alone expire. Selling the Jordans' mineral interest at a tax sale without notice was an unconstitutional taking and a violation of due process. The Court finds that selling property at a county tax sale without any notice to the legal owner of the property is repugnant to fundamental fairness.

Further, record notice does not absolved the County of the problem. First, record notice does not satisfy the requirements outlined in *Jones v. Flowers*. Second, the record notice showed that the tax lien date was January 16, 1996, which all parties agree was a clerical error, but nonetheless would not have given the Jordans accurate notice that their mineral interest may be in jeopardy of being sold. The County also admits that the Uintah County Assessor did not assess the mineral rights in this case and did not believe he was required to do so. Therefore, even if the Jordans had reviewed the record and inquired of the County concerning a potential sale of their interest, the County would have affirmed that their property was not subject to the tax sale. Finally, an actual inspection of the land during the time of the tax sale or four years after would not have given the Jordans any indication that their mineral interest had been sold at a tax sale. There was no development on the overlying surface property, nor was there any physical evidence of production of the mineral interest.

Because there was no actual notice of the tax sale, record notice was insufficient and inaccurate, and because there was no physical evidence to suggest to the Jordans that the property might have been sold, the Court finds that the sale was repugnant to fundamental fairness. The sale, if intended to convey the severed mineral interests, was without due process of law, and resulted in an unconstitutional taking. Consequently, pursuant to *Frederiksen* footnote 14, the statute of limitations does not apply to bar the Jordans' challenge to the tax sale.

IV. Whether the heirs of Marie Robertson and Caroline Kelley have standing to assert the due process claims?

Finally, the Jensens argue that the heirs of Marie Robertson and Caroline Kelley lack standing to assert the due process rights. Marie Robertson and Caroline Kelley passed away in 2003 and 2002, respectively. Ms. Robertson's and Ms. Kelley's heirs are some of the Plaintiffs claiming and interest in the property.

"[I]n Utah, as in the federal system, standing is a jurisdictional requirement." *Brown v.*

Div. of Water Rights of Dep't of Natural Res., 2010 UT 14, ¶ 12, 228 P.3d 747. "As a general rule, courts do not permit a party to assert the constitutional rights of a third party." *Shelledy v. Lore*, 836 P.2d 786, 789 (Utah 1992). "[A] litigant must assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties." *Id.*

However, "it has long been recognized that the surviving claims of a decedent must be pursued by a third party." *Hodel v. Irving*, 481 U.S. 704, 711 (1987). "[P]ermitting appellees to raise their decedent's claims is merely an extension of the common law's provision for appointment of a decedent's representative. It is therefore a 'settled practice of the courts' not open to objection on the ground that it permits a litigant to raise third parties' rights." *Id.* at 712.

There are "two factors to be considered in determining when the third-party rule should be suspended: the relationship of the litigant to the person whose right he seeks to assert, and the ability of the third party to assert his own right." *Irving v. Clark*, 758 F.2d 1260, ¶18 (8th Cir. 1985). In *Lewis v. Grinker*, 111 F. Supp 2d 142, 168 (E.D.N.Y. 2000), the court explained:

> [m]oreover, as other courts have observed, the relationship between a parent and child is much closer than those involved in other cases in which third-party standing has been found to exist . . .[t]he relationship between parent and child has been deemed to be "more than sufficient to address the concerns that underlie the prudential doctrine" of third-party standing. *Elias v. United States Dep't of State*, 721 F. Supp. 243, 246-47 (N.D.Cal. 1989). Other courts have permitted a child to assert his or her parent's equal protection rights in challenging the validity of statutes that conferred United States citizenship on the foreign-born offspring of United States citizen fathers, but not United States citizen mothers, *see Wauchope v. United States Dep't of State*, 985 F.2d 1407, 1411 (9th Cir. 1993); *Elisa*, 721 F. Supp. at 246-47, or which chilled the parent's right to adopt a child, *see Lindley ex rel. Lindley v. Sullivan*, 889 F.2d 124, 129 (7th Cir. 1989) . . . Further, the effectiveness of a parent's representation of his or her child is reflected in the well-established tradition that permits parents to sue as the representatives of their minor children and to "maintain litigation that rests directly on the standing of the children themselves." 13 Wright *et al.*, Federal Practice and Procedure: Jurisdiction 2d § 3531.9 (2d ed. 1984); *see also, e.g., Sherman v. Community Consol. Sch. Dist. 21*, 980 F.2d 437, 441 (7th Cir.

1992).

Here, Marie Robertson and Caroline Kelley are deceased and cannot pursue their constitutional claims. As set forth above, they did not receive notice, and were not aware of their potential constitutional claims before they died. Because they did not receive notice, they were not able to pursue their constitutional claims before their deaths. The Plaintiffs, as heirs of Marie Robertson and Caroline Kelley, also did not receive notice of the assessment, taxes, or sale.

As in *Wauchope v. U.S. Dept. Of State*, 756 F. Supp. 127 (N.D. Cal. 1991), it is "undisputed Plaintiffs' interests are harmonious with and at least as strong as the interest that (their) mother would have asserted." The Plaintiffs, as children of Marie Robertson and Caroline Kelley, have a sufficiently close relationship to satisfy the relationship factor in the third-party standing test. The Court finds that the Plaintiffs have third-party standing to assert the constitutional claims.

V. Whether Portions of Rolene Rasmussen's Affidavit should be Stricken?

In a separate motion, but in conjunction with its Motion for Partial Summary Judgment, Jensens moved the court to strike certain portions of Rolene Rasmussen's testimony contained in an affidavit. Jensens argue that the offending portions of the affidavit are legal conclusions not based upon personal knowledge, rather than statements of fact. The particular paragraphs complained of read as follows:

6. The Uintah County Assessor's office does not assess mineral rights. Mineral rights are handled by the Utah State Tax Commission.

7. The mineral rights on the Property would not have been included in and would not

have been part of the Uintah County assessment of the Property in 1995 or any years thereafter.

9. Mineral rights are not included in any appraisal of real property by the Uintah County Appraiser's office since the mineral rights are not assessed by the county.

The Court finds that the statements can be read either as statements of fact or as legal conclusions. The statement that the Uintah County Assessor's office does not assess mineral rights can be taken as a statement of fact if Rasmussen has knowledge that the office makes no attempt to value or assess mineral rights. Further, if Rasmussen knows that the office doesn't separately assess mineral rights that have been severed from surface rights, such is a statement of fact. Finally, if Rasmussen knows that appraisers in Uintah County don't attempt to value minerals when performing appraisals for assessment purposes, such is a statement of fact. The Court accepts Rasmussen's statement to establish these facts.

To the extent that Rasmussen's statement attempts to reach the ultimate legal conclusions in this case, the Court disregards Rasmussen's statement for that purpose.

Order

The Jordans' and Axia's Motions for Summary Judgment are granted. The Jensen's Motion for Summary Judgment is denied. The Court quiets title to the mineral interest in the Jordans. Pursuant to *Code v. Utah Dept. of Health*, 162 P.3d 1097 (Utah 2007), and Utah R. Civ. P. 7(f)(2), the parties are notified that this is the final ruling and order in this case. The parties need not prepare or submit any other order.

Dated this 18 day of Feb, 2015.

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BY THE COURT:

Samuel Chiara

SAMUEL P. CHIARA, District Court Judge

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